SO ORDERED: January 2, 2018.

Robyn L. Moberly
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

IN RE:	)	
	)	
RANDALL LEE PULLIAM	)	CASE NO. 16-01607-RLM-7A
Debtor	)	
_____	)	
	)	
JOHN MICHAEL STAFFORD,	)	
INDIVIDUALLY AND ON BEHALF	)	
Of ALTO PASS AUTO, LLC,	)	
	)	
Plaintiffs	)	
	)	
v.	)	Adversary Proceeding
	)	No. 16-50141
	)	
RANDALL LEE PULLIAM.	)	
	)	
Defendant.	)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

THIS MATTER came before the Court for a bench trial, commencing on November 1, 2017 and concluding on November 3, 2017. At the conclusion of the trial, the Court took the matter under advisement. The Court, having reviewed the evidence presented at the trial, the parties' trial briefs, and the other matters of

record in this adversary proceeding; having heard the presentations of counsel at the trial; and being otherwise duly advised, now finds that the debt owed to the Plaintiff is dischargeable and enters the following findings of fact and conclusions of law as required by Fed. R. Civ. P. 52, and made applicable to this adversary proceeding by Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

Plaintiff John Michael Stafford ("Stafford") first got involved in the car sales business when he operated a wholesale car buying business for management level personnel at a local hospital and a medical diagnostics company. He paid a fee to a car dealer to use the dealer's license to purchase the vehicle desired by the hospital or company employee and then sold the employee the car at a profit. Stafford formed Alto Pass Auto, LLC, ("APA") as an Indiana limited liability company on February 23, 2004 and referred to this aspect of APA's business as the "wholesale" business. An operating agreement from 2006 indicated that Stafford was APA's only member.

The car dealer who allowed Stafford to purchase vehicles under his dealer's license retired and he gave his license to Stafford. Stafford decided to expand APA's business and form a "buy here, pay here" car brokerage business, separate from Stafford's wholesale business. A dealer's license was needed to operate a retail car business but a pre-existing location from which to operate the business was a requirement to obtain the dealer's license. APA negotiated a lease with Keystone Real Estate LLC ("Keystone") and Prime Time Rentals ("PTR") through their mutual agent, Jeffery Zahner for space located at 7270 North Keystone Avenue, Indianapolis, Indiana. APA obtained its car dealer's license from the Indiana Secretary of State in March 2010. Stafford "brought in" Mark Eaton as a member of APA in 2010, although the extent of Eaton's membership interest in APA is unclear.

. APA's primary method for procuring car inventory was for individuals (consignors) associated with APA to purchase the cars themselves, place them on

the APA car lot, sell them, and deposit the sale proceeds with APA. APA in turn would pay a percentage of the sale price to Stafford for his profit and the remainder to the consignor. APA's former bookkeeper testified that APA did not own any of the cars on the lot and that all car sales were sold on consignment, a fact that Stafford denies.

Another way that APA procured inventory was for "investors" to "loan" money to APA to purchase cars. For example, Gary Myers ("Gary"), Bob Myers ("Bob") and Dave Windley all loaned APA money sometime before 2012. Although the notes reflect the borrower was APA, they were guaranteed by Stafford. The loans were not secured, despite testimony to the contrary from Stafford. In fact, the notes were demand notes without reference to the intended use of the money. Gary loaned $45,000 between November 2009 and January 2010. Stafford's testimony about how the transactions occurred differed from how the loan transactions actually unfolded. Stafford claimed he treated these transactions as secured loans whereby the investor that provided the money to Stafford to purchase a car would have a right to the sale proceeds when that particular car was sold. However, the investors received 11% interest on their promissory notes, which was satisfactory with them as long as the interest was paid timely. There was no testimony that any investor actually received a lump sum payment upon the sale of a car. Stafford personally guaranteed payment of Gary's loans. Although the loans were made to APA, the funds loaned by Gary were placed in a separate account out of which Stafford ran his personal wholesale business and over which only Stafford had access. No certificates of title were offered at trial to show that they were titled in APA's or Stafford's name and no car titles or financing statements were offered at trial to establish that the investors had a perfected lien in them.

APA or Stafford also had a floorplan financing arrangement with Manheim Automotive Financial Services ("Manheim") whereby APA or Stafford bought cars at Manheim's auto auction on credit issued by Manheim. Manheim would be paid a percentage every month until the car for which Manheim provided credit was sold. Manheim would be paid the balance owed from the sale proceeds.

APA managed its car inventory by assigning each car on the lot a stock number. The first initial of the first name of the person who provided the funds that purchased the car was included at the beginning of the stock number. For example, cars purchased with Gary's funds were assigned stock numbers which began with a "G".

Defendant Randall Pulliam ("Pulliam") had worked at a Nissan car dealership with Ben Stafford, Stafford's son. Stafford hired Pulliam as a salesman and Pulliam proved to be a "good fit". Pulliam quickly assumed more responsibilities and became general manager of APA in mid-2010. Pulliam's duties included paying business expenses, paying APA's taxes and overseeing 's APA's day-to-day operations. In mid-October 2010, Stafford sold 10% of his interest in APA to Pulliam for $6,250.

In late 2011, Stafford contemplated retirement and he and Pulliam discussed transfer of 51% of APA to Pulliam but these discussions never resulted in a signed agreement. Stafford vacationed in Florida in December 2011 and January 2012 but cut his vacation short when Pulliam notified him by letter that he was resigning from the business and relinquishing his membership interest in APA because he was neither happy nor comfortable with Stafford's business practices. Stafford returned to what he described as his business having been "taken away from him" without his consent. He discovered that Pulliam had negotiated and entered into a new lease for the same premises and was doing business on the premises as "Auto Pass Sales & Service, Inc." ("Auto"). Pulliam established a new floorplan financing agreement in Auto's name with Manheim and had transferred APA assets to Auto.

In dramatic contrast, Pulliam and other witnesses painted a picture that it was Pulliam who righted the wrongs caused by Stafford's suspect business practices and that all transfers were either known and authorized by Stafford or were of property that was not owned by either Stafford or APA. APA's financial records were woefully unreliable. Ownership of APA was in constant flux as various versions of operating agreements, some unexecuted, differed in who the members of APA were. An unexecuted copy of an operating agreement dated October 2010 listed

Kevin Coulter as a member. Coulter is not named as a member in the February 22, 2011 operating agreement which listed ownership as follows: Stafford (58%), Ben Stafford (10%), Pulliam (10%), Mark Eaton (18%) and Gary Vaught (4%). When Pulliam became general manager of APA in mid-2010, he believed that Stafford owned 100% of APA. Ben Stafford denied being a member.

APA's bank account was held with TCU but there were other bank accounts in Stafford's name and APA's name and the accounts were comingled. The investors' loans were deposited in another account to which only Stafford had access, and thus, Pulliam was not aware of the investors' loans. Pulliam maintains the investor loans amounted to nearly $100,000 at the time he became general manager. Larry Marietta was hired in late 2011 to prepare APA's 2010 tax returns, but the state of APA's books and records were such that the data gathering for Marietta was "messy" and Marietta "just couldn't get to a comfort level on data". Marietta limited his engagement only to the 2010 returns.

Nikki Issacs began working for APA as a bookkeeper in late 2010. She was asked to put the books together starting from August 2010. She testified it was "nearly impossible" to put the books for 2010 together because deposits and checks were undocumented. Stafford comingled business funds with his personal funds and Issacs reminded him that this was improper. There were no cars in inventory that were owned by APA. All of the cars on the lot were on consignment, having been purchased with the personal funds of individual members or with the "investor" loans.

Most, if not all, of the cars on APA's lot as of late 2010 were cars purchased by Pulliam or Kevin Coulter and sold on consignment. Stafford purchased cars with Gary's investor loan and placed cars on the lot in 2011. Stafford directed Issacs to construct a list of car inventory purchased with Gary's funds and instructed her to devise a spread sheet to track that inventory. There was no documentation to verify that the cars ultimately put on the list were in fact purchased with Gary's funds. She and Stafford were the primary sources of information from which Marietta prepared the 2010 tax return. Marietta had included in the 2010 tax

return that Stafford had provided $100,000 in equity to APA but, to Issacs' knowledge, there was no documentation that could be traced to Stafford's $100,000 infusion of capital.

The entire business arrangement began to fall apart when, in November 2011, Stafford purchased a 2009 Lexus for a client at auction under APA's Manheim floor plan financing arrangement. The Lexus was delivered to the client in Texas but was the wrong color and had slight damage. The client refused delivery. As a result, Stafford did not make the monthly percentage payment to Manheim. Cox Enterprises, Manheim's auditor, performed audits every 30 days to verify that the cars purchased at auction under the floorplan arrangement were on the APA car lot or otherwise accounted for. When it was discovered that the 2009 Lexus was not on the lot, Stafford told the auditor that the loan on the 2009 Lexus was being arbitrated with Manheim. (In this context, arbitrated means returned to the auction for credit but it could also mean the dispute was being informally negotiated). Cox Enterprises verified with Manheim that there was no such arbitration, and Manheim put the APA account on lockdown status because it could not locate the Lexus. The Lexus was eventually located and brought back to Indiana where Dave Windley worked a trade and cash payment for the Lexus. Pulliam paid the debt owed to Manheim from his personal funds to appease Manheim. However, the lockdown on the floor plan financing account remained in place for APA and Stafford.

Stafford had attempted to return vehicles purchased at auction or arbitrate their price with Manheim in the past, a business practice Manheim found unacceptable. After the Lexus incident, Manheim would not work with Stafford as long as he was the only party to the floor plan agreement. The APA operating agreement allegedly was amended to show that Pulliam had a 42% ownership stake, but Pulliam surmised that it was done by Stafford "just for show" to get Manheim to release the hold on the account. Pulliam believed he never owned more than 10% of APA.

Gary, Robert Myers and Dave Windley consistently received monthly interest payments on their investor loans until late 2011. It was about this time that Stafford approached Gary and indicated he was contemplating selling APA to Pulliam and Pulliam would be responsible for repayment of the investor loans. Gary was concerned that repayment of his and other investors' loans would be made by Pulliam who was not obligated on the notes, and whom Gary had never met and with whom he never dealt. Once it became clear that Stafford was not able to pay the three investors' loans in full, Gary allowed the other two investors' loans to be paid first. Pulliam continued to make payments to Gary for about year after Auto was formed.

Pulliam's letter of resignation, effective December 1, 2011, indicated that Stafford had been made aware that Pulliam had assumed the APA lease. Email correspondence of February 21, 2012 from Pulliam to Stafford recited that Stafford asked to be removed from the lease. As of March 14, 2012, Stafford and Pulliam discussed resolution of their differences as follows: (1) Stafford would pay Gary Myers and Robert Myers the amounts owed on investor loans incurred prior to Pulliam's involvement with APA; (2) Pulliam would execute and pay a new note in favor of Gary Myers; and (3) Pulliam would relinquish his 10% ownership of APA and would not seek reimbursement of the $6250 purchase price. Still unresolved was (1) whether Stafford would be released from the Gary Myers notes; (2) the amount Stafford would pay on the TCU line of credit and (3) whether Pulliam would reimburse Stafford for APA's deposits and equipment that were transferred to Auto. Nikki Issacs suggested that Stafford drop his demand for these reimbursements and "call it a wash" because Pulliam had paid Manheim over $9800 of his personal funds to resolve the Lexus dispute.

From December 2011 through March, 2012, APA continued to operate with Pulliam as the general manager and Pulliam continued to use APA's dealer's license which he maintains was with Stafford's consent. Pulliam eventually cut off all direct contact with Stafford and applied for Auto's dealer's license in January 2012. Auto began operations in March 2012. Pulliam applied for and was approved for a

floorplan financing arrangement with Manheim and set up this new account in Auto's name. Manheim would not have agreed to set up a new account had Stafford remained involved.

Pulliam filed a voluntary petition under Chapter 7 on March 10, 2016. Stafford timely filed his Complaint to Determine Dischargeability of Debt, alleging that the debt owed by Pulliam is nondischargeable under 11 U.S.C. 523 §§(a)(2), (a)(4) and (a)(6).

CONCLUSIONS OF LAW

Exceptions to discharge under §523 are "to be construed strictly against the creditor and liberally in favor of a debtor." *In re Scarlata*, 979 F.2d 521,524 (7th Cir. 1992). Stafford seeks nondischargeability under §523(a)(2)(A), §523(a)(4) and §523(a)(6). Each has its own elements that a plaintiff must prove by a preponderance of the evidence *Grogan v. Garner*, 498 U.S. 279, 289-90 (1991).

523(a)(2)(A)

A debt "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..." is nondischargeable under §523(a)(2)(A). "False pretenses" or "false representation" requires proof that (1) the debtor obtained money, property or services through a false pretense or false representation of fact, (2) which the debtor (a) either knew to be false or made with such reckless disregard for the truth as constitute a willful misrepresentation and (b) made with intent to deceive; and (3) upon which the creditor justifiably relied. *Ojeda v. Goldberg*, 599 F.3d 712, 716-17 (7th Cir. 2010). "Actual fraud" has a broader meaning and involves "any deceit, artifice, trick or design involving direct and active operation of the mind used to circumvent and cheat another" which includes "all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated". *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000). Proof of a debtor's misrepresentation or a creditor's reliance is not necessary to prove actual fraud. *Husky International Electronics, Inc. v. Ritz,,* 136 S.Ct. 1581 (2016); *McClellan* 217 F.3d at 893. A

creditor must prove (1) a fraud occurred; (2) the debtor intended to defraud the creditor at the time the fraud occurred and (3) the fraud created the debt that is the subject of the nondischargeability action. *Id.*

523(a)(4)

Under §523(a)(4), an individual debtor shall not be allowed a discharge for any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny". Whether the debtor was acting in a fiduciary capacity is a question of federal law and what may be a fiduciary relationship under nonbankruptcy law may not qualify as such under §523(a)(4). *In re Frain*, 230 F.3d 1014,1017 (7th Cir. 2000;); *In re Fowers*, 360 B.R. 888, 895 (Bankr. N. D. Ind. 2007). The Seventh Circuit has found that a "fiduciary" for §523(a)(4) purposes includes certain relationships where the law imposes fiduciary obligations, such as the duty an attorney owes to a client or a director owes to shareholders. *In re Berman,* 629 F.3d 761, 768 (7th Cir. 2011); *In re Marchiando*, 13 F.3d 1111, 1115 (7th Cir. 1994). A relationship that involves a "difference in knowledge or power between fiduciary or principal which...gives the former a position of ascendancy over the latter", qualifies as a fiduciary relationship under §523(a)(4*). Frain*, 230 F.3d. at 1017; *In re Woldman*, 92 F.3d 546, 547 (7th Cir 1996) ("section 523(a)(4) reaches only those fiduciary obligations in which there is substantial inequality in power or knowledge in favor of the debtor seeking the discharge and against the creditor resisting discharge"). Fiduciary obligations between equals, such as general partners in a partnership or joint venturers, generally do not qualify unless the debtor possessed substantial inequality of power or knowledge over the creditor seeking nondischargeability. *Id.* The fiduciary's obligation must exist prior to the wrongdoing. *Marchiando*, 13 F.3d at 1116.

The debtor must also commit "fraud or defalcation" in his fiduciary capacity. "Fraud" for purposes of this section involves intentional deceit. "Defalcation" involves tortious conduct which is more than mere negligence but less than fraud. *Berman*, 629 F.3d at 771. A fiduciary commits defalcation where he consciously disregards or is willfully blind to a substantial and unjustifiable risk that his

conduct will turn out to violate a fiduciary duty. *Bullock v. BankChampaign, N.A.,* 596 U.S. 267, 274 (2013).

The "embezzlement" and "larceny" prongs of §523(a)(4) do not require proof of a fiduciary relationship. Embezzlement is the "fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come." *In re Weber*, 892 F.2d 534, 538-39 (7th Cir. 1989), *abrogated on other grounds by Grogan v. Garner*, 489 U.S. 279, 291 (1991). It is not sufficient that the debtor act without authority, she must also have fraudulent intent where she knows her use of property is unauthorized. *In re Liebl*, 434 B.R. 529, 537 (Bankr. N.D. Ill. 2010); *In re Buchanan*, 13-80378-JMC-7, 2015 WL 996233 at *16 (Bankr. S. D. Ind. March 2, 2015). "Larceny" under §523(a)(4) requires a showing that the debtor wrongfully took property from its rightful owner with fraudulent intent to convert such property to his own use without the owner's consent. *Id.* Embezzlement differs from larceny in that embezzlement requires that the initial taking of property was lawful or with the consent of the owner whereas larceny requires a felonious intent at the time the property was taken. *Id.*

523(a)(6)

A debt "for willful and malicious injury by the debtor to another entity or to the property of another entity" may be excepted from discharge pursuant to §523(a)(6). To obtain a determination of nondischargeability under Section 523(a)(6), a creditor must prove: (a) that the debtor intended to and caused an injury; (b) that the debtor's actions were willful; and (c) that the debtor's actions were malicious. *First Weber Group, Inc. v. Horsfall*, 738 F.3d 767, 774 (7th Cir. 2013). "Willfulness requires 'a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury.' " *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998). Maliciousness requires the debtor to act "in conscious disregard of one's duties or without just cause or excuse; it does not require ill-will or specific intent to do harm." *Horsfall*, 738 F.3d at 774-775. The Seventh

Circuit has articulated the §523(a)(6) standard concisely as "a willful and malicious injury, precluding discharge in bankruptcy of the debt created by the injury, is one that the injurer inflicted knowing he had no legal justification and either desiring to inflict the injury or knowing it was highly likely to result from his act". *Jendusa-Nicolai v. Larsen*, 677 F.3d 320, 322, 324 (7th Cir. 2012).

A debtor's intent to deceive must be proven under §523(a)(2)(A), §523(a)(4) and §523(a)(6). "Direct evidence of a fraudulent intent is rarely before the court" and thus, an intent to deceive may be established through circumstantial evidence and may be inferred from the totality of the circumstances. *In re Haskell,* 475 B.R. 911, 921 (Bankr. C.D. Ill. 2012). .

Stafford maintains that Pulliam (1) wrote checks on APA's account and transferred cars owned by APA to Auto without authority or Stafford's consent and (2) misappropriated funds from car sales that should have been paid to Stafford or APA . Stafford's primary argument appears to be that Pulliam converted Stafford's or APA's property to his personal use. Stafford retained Patrick Sanders, a CPA who also prepared Stafford's personal tax returns, to prepare a report detailing the transfers and the losses caused as a result.

The first and third parts of Sanders' report concluded that Pulliam wrote $67,691.10 worth of unauthorized checks on the APA account and transferred 17 cars worth $170,609.41 to Auto. The Court first notes that there is no clear evidence of what property APA or Stafford owned. APA was primarily a consignment business. The Court finds the testimony of Nikki Issacs to be most credible. APA did not own any car inventory, but rather was only the pass-through with which the sale proceeds were deposited and from which they were disbursed. Proceeds from consignment sales were the property of the consignor, subject to the agreed-upon percentage to be paid to Stafford. From the testimony at trial, it is impossible to know who owned the cars purchased with Gary Myers' money. No certificates of title were produced. There was no proper accounting made of the disposition of Gary's loans. It is most likely Stafford accessed the proceeds from the loans for his personal benefit.

None of the purchase orders or odometer disclosure statements for the 17 cars transferred from APA to Auto indicated they were owned by APA or by only Stafford. Two of the 17 cars had stock numbers that began with the letter "J" (for Joanne Coulter) and five of the cars had stock numbers that began with the letter "Z" (for Zac Walton), indicating that those two individuals purchased those cars. One car was a trade-in and did not have a letter preceding the stock number and another car had the letters "G' and "B" (indicating Gary and Bob Myers). Six of the remaining eight cars had stock numbers that began with the letter "R", indicating that Pulliam had purchased those cars. The last 2 cars had both an "R" and an "M" (for Pulliam and Stafford) preceding the stock number. At best, Stafford might have owned two of the 17 cars that Pulliam allegedly converted but has failed to prove by preponderance that Pulliam converted sale proceeds from these cars to his own use. The record is clear that Pulliam continued to pay Gary Myers on his investor loan for a year after Auto was formed, despite the fact that it was Stafford's obligation. There is no evidence of conversion.

Nor has Stafford proven by a preponderance that the $67,691.10 worth of checks written by Pulliam on the APA account were unauthorized or that Pulliam converted any of those funds. Pulliam was the designated managing member of APA and authorized to use APA funds to pay obligations of APA. To the extent these funds were from consignment sales, they may not have been property of APA or Stafford. All but three of the checks were made payable to Auto or were from customers who were instructed to make their check payable to Auto. The other three were made payable to PTR for February 2012 rent, and to two vendors. All but one of the checks were written in January or February 2012. The one exception is a check made payable to a vendor written in December, 2011.

The record is replete with references to Stafford's retirement and Pulliam taking over the business for him. Stafford and Pulliam engaged in discussions about transfer of the business and the business lease to Pulliam as early as November 2011. Those discussions included payment of APA's obligations. Although no formal written agreement was reached, Pulliam nonetheless took over

APA for a short time until Auto obtained its dealer's license. Stafford had lost interest in APA and wanted to retire. APA and Stafford's access to floor plan financing had been terminated by Manheim. Pulliam formed Auto because he no longer wanted to be associated with Stafford's bad credit and suspect business practices. Pulliam attempted to pay APA's obligations that were incurred after he became involved with APA and transfer of funds from APA to Auto was consistent with that plan. Emails as early as January 5, 2012 between Gary and Dave Windley indicate that Stafford was going to sell the business to Pulliam and transfer the business lease to him. From their dealings with Stafford, Gary and Dave Windley believed Stafford wanted to "turn everything over" to Pulliam and Stafford was happy to get out the business. In the March 2, 2012 email from Stafford to Nikki Issacs, Stafford himself indicated that "under no circumstances" did he want a car lot. There is no proof that Pulliam improperly converted any funds to his own use.

The second part of Sanders' report details how Pulliam wrote 7 checks totaling $23,893.79 on APA's account to himself. The memo line on each of those checks indicates that they are to reimburse Pulliam for his cars that were sold on consignment. Each memo line contains the stock number of the vehicle sold and each stock number is preceded with the letter "R". Stafford has not proven that what was allegedly converted was his property or APA's property. To the extent that they were the property of APA or Stafford, they represent commissions to which Pulliam was entitled, and Stafford has not shown that they were something else. To the extent Pulliam owes a debt to Stafford, it is dischargeable under §523(a)(6).

Any debt owed is dischargeable under §523(a)(2)(A) and (a)(4) for the same reasons. Stafford has not articulated any misrepresentation made by Pulliam that would come under the "false pretenses" or "false representation" prongs of §523(a)(2)(A). "Actual fraud" does not require a misrepresentation, but Stafford failed to prove that Pulliam had the requisite intent to defraud him.

Fiduciary obligations between equals, such as general partners in a partnership or joint venturers, generally do not qualify as fiduciaries for §523(a)(4) unless the debtor possessed substantial inequality of power or knowledge over the creditor seeking nondischargeability, *Woldman*, 92 F.3d at 547. No evidence exists that there was inequality of power over or knowledge of APA to Pulliam's advantage. In fact, the evidence suggests that Stafford had an inequality of power and knowledge over Pulliam. Pulliam never owned more than 10% of APA and did not have access to Stafford's wholesale business or the bank account where the investor loans were deposited. Even if Pulliam qualified as a fiduciary for §523(a)(4) purposes, Stafford failed to show how Pulliam committed defalcation. While defalcation is "something less" than fraud, it still involves tortious conduct and requires a showing that Pulliam consciously disregarded or was willfully blind to the risk that his conduct was a violation of his fiduciary duty. The unrefuted evidence shows that Pulliam managed APA properly and made a good faith effort to pay off its obligations, at times with his personal funds.

To the extent Pulliam owes a debt, it is dischargeable under all theories advanced by Stafford. The Court will issue judgment accordingly.

# # #

.