Not intended for publication

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
EASTERN DIVISION

IN RE

BILLY G. WOFFARD, **CASE NO. 97-12368**

Debtor. **Chapter 7**

UNION PLANTERS BANK OF WEST TENNESSEE,

Plaintiff,

v. **Adv. Pro. No. 97-5260**

BILLY G. WOFFARD,

Defendant.

MEMORANDUM OPINION AND ORDER RE COMPLAINT TO DETERMINE DISCHARGEABILITY

The complaint to determine dischargeability in this case arises from a floor plan financing agreement that the defendant, Billy G. Woffard and his partner, Jerry Wendell Hitchcock, entered into with the plaintiff, Union Planters Bank of West Tennessee, in 1993. Woffard and Hitchcock each filed individual chapter 7 bankruptcy petitions in 1997. Union Planters filed dischargeability complaints in both cases. The complaint against Hitchcock was resolved prior to trial by an agreed order which found the debt owed to Union Planters to be nondischargeable in the amount of $188,499.74. The issue before the Court today is whether or not Hitchcock's misconduct can be imputed to Woffard under the principles of partnership liability and the Bankruptcy Code.

This Court conducted a trial in this matter on July 17, 1998. FED. R. BANKR. P. 7001. Pursuant to 28 U.S.C. § 152(b), this is a core proceeding. After reviewing the testimony from the hearing and the record as a whole, the Court makes the following findings of facts and conclusions of law. FED. R. BANKR. P. 7052.

I. FINDINGS OF FACT

From the Autumn of 1993 until the Spring of 1997, the debtor in this case, Billy G. Woffard, ("Woffard"), was partners in a used car dealership with Jerry Wendell Hitchcock, ("Hitchcock"). The dealership was located in Dyersburg, TN, and did business under the name "Auto Plaza." According to the testimony at the trial, Woffard was the one with expertise in the car sale business, while Hitchcock was the "money man." Woffard and Hitchcock were the only two employees of Auto Plaza at all times.

On November 29, 1993, Auto Plaza, by and through its partners, Woffard and Hitchcock, entered into a floor plan financing agreement with First Exchange Bank (now Union Planters Bank of West Tennessee ("Bank")). Under this agreement, the bank agreed to finance "the Dealer's acquisition and/or holding of motor vehicles for resale in the course of the Dealer's business." In return for this financing, Auto Plaza was to remit the proceeds to the Bank as the vehicles were sold. Woffard's testimony at trial, as well as Hitchcock's deposition,[1] established that when a car which had been financed by the Bank was sold, either Woffard or Hitchcock would go to the Bank, get the title from the Bank, and fill out an "Acknowledgment of Receipt of Title" form. The partner would then return to the dealership and complete the transaction. When the money was received on a particular sale, the partner was supposed to take the money to the Bank and pay off the car that had been sold. Both Woffard and Hitchcock testified that Hitchcock was responsible for going to the Bank to retrieve the title and pay off the loan the majority of the time. In his deposition, Hitchcock admitted that he always knew his obligation was to take the money from the customer to the bank.

In addition to the Floor Plan Financing Agreement, Auto Plaza executed a Security Agreement with the Bank which gave Union Planters a security interest in:

> All inventory (including, without limitation, the motor vehicles being or to be purchased pursuant to this financing arrangement) accounts receivable and general intangibles, whether now owned or hereafter acquired, including the proceeds therefrom together will [sic] all proceeds (including insurance proceeds) and products attributable or accruing to the Collateral which the Debtor may hereafter become entitled to receive.

A Master Note in the amount of $150,000 was also executed at this time between Auto Plaza and the Bank. Hitchcock presented the Bank with a Guaranty for $200,000 on this date. Subsequently, on

[1] Hitchcock's January 29, 1998, deposition was introduced into evidence at Woffard's trial by agreement of the parties.

October 1, 1994, Hitchcock and Woffard signed a Guaranty for a floor plan increase of $150,000.00. Approximately eight months after this increase, on May 24, 1995, Auto Plaza executed another Floor Plan Financing Agreement, Security Agreement and Master Note with the Bank in the amount of $300,000.00.

Everything went according to the various agreements for over two years. Sometime in 1995 or 1996, however, Hitchcock began to engage in what may be termed "fraudulent" behavior. Instead of remitting the proceeds from a sale to the bank when a car was sold, Hitchcock would sometimes deposit the money in Auto Plaza's account. According to Hitchcock's testimony in his deposition, the procedure he would follow when engaging in this wrongful behavior was as follows:

1. When a car was sold, Hitchcock would go to the Bank and obtain the title.
2. He would then return to the dealership and complete the transaction with the customer by collecting the purchase price for the vehicle sold.
3. Hitchcock would then fill out a check stub in Auto Plaza's checkbook to make it look like he was depositing the proceeds with the Bank, but instead he would deposit the money into Auto Plaza's account.

This failure to remit to the Bank was sporadic and continued until the dealership was shut down by the Bank in April 1997. At trial, the Bank's representative testified that there were ten automobiles for which the proceeds were unaccounted. The titles on all of these missing cars had been released to Auto Plaza. At the time of Woffard's trial, the total balance of the floor plan agreement owed to the Bank was $188,499.74.

According to Hitchcock's deposition, the money which he wrongfully deposited in Auto Plaza's account was used to pay other bills of the partnership which were past-due. When asked if he knew how much money he had wrongfully deposited into Auto Plaza's account, Hitchcock replied "No." Hitchcock also stated that he never kept any money from the sale for himself personally. He always deposited the entire amount in Auto Plaza's account.[2]

[2] Despite the fact that Hitchcock stated he never kept any of the proceeds for himself personally, he did admit to withdrawing some money from Auto Plaza's account to which he was not entitled. Both Hitchcock's deposition and Woffard's trial testimony set forth that on one or two occasions, Hitchcock wrote himself checks for $3000 or $4000 on Auto Plaza's account. Aside from this testimony, however, no proof of these withdrawals was introduced at trial.

In order to further help out with Auto Plaza's bleak financial condition, Hitchcock entered into a loan agreement with Bill Bland to borrow $25,000 in 1996. No promissory note was executed, nor was the money ever paid back. The circumstances surrounding the exchange of money itself are somewhat shady. Apparently, Bland brought the money to Hitchcock at Auto Plaza in a brown paper bag. According to Woffard's trial testimony and Hitchcock's deposition, Woffard was at the dealership at the time of this transaction, but the actual hand-off of money between Hitchcock and Bland took place in a back office with the door closed.[3]

According to Woffard's testimony at trial, Woffard was unaware of both Hitchcock's wrongful deposit of the proceeds from the sales and the $25,000 Bland loan. Auto Plaza's checkbook register had been filled out by Hitchcock to look as if the proceeds had been remitted to the Bank. The transaction between Hitchcock and Bland was done behind closed doors. No inventory was done by the Bank until early 1997. Upon cross-examination, however, Woffard admitted that during the entire time he and Hitchcock were partners he had full access to all of Auto Plaza's records.

Woffard finally discovered Hitchcock's fraudulent behavior in late 1996/early 1997 when he began to try to reconcile the bank statements with Auto Plaza's check stubs. When Woffard was unable to do this, he confronted Hitchcock about the fact that it appeared that the proceeds of the sales were not being paid to the Bank. Hitchcock told Woffard that he would take care of it and not to worry about it.

The Bank became aware of the missing cars and money in April 1997. At that time, they demanded payment for the missing cars. When the proceeds were not turned over, the Bank shut the dealership down.

Both Woffard and Hitchcock filed individual chapter 7 bankruptcy petitions in the Summer of 1997. Hitchcock filed his on July 21, 1997, case number 97-12620 and Woffard filed his on July 1, 1997, case number 97-12368. The Bank filed adversary proceedings against both Hitchcock (adversary proceeding number 97-5261) and Woffard (adversary proceeding number 97-5260) on September 25,

[3] When depositing this $25,000 into Auto Plaza's account, Hitchcock made three separate deposits of approximately $8,000.00. The reasoning offered by Hitchcock for this division of the $25,000 was that any deposits of $10,000 or more required some paperwork and documentation. In order to avoid the necessity of preparing these documents and thus drawing attention to the money, Hitchcock split the $25,000 up and deposited each sum separately.

1997. Hitchcock received a discharge of his debts except as to the Bank's adversary complaint on March 3, 1998. Woffard received his discharge except as to the Bank's complaint on October 23, 1997.

In its complaints against both Hitchcock and Woffard, the Bank alleged that the partners had acted in bad faith, had failed to explain the loss or deficiency of assets, and that they had intercepted funds which were the property of the Bank. The Bank sought to except the debt owed to them from the debtors' discharges under 11 U.S.C. § 523 and to deny discharges to both debtors under 11 U.S.C. § 727.

Trials on both complaints were set for July 17, 1998. On that date, the attorney for the Bank announced that Hitchcock had entered into an agreed order with the Bank which declared the debt to be non-dischargeable in the amount of $188,499.74.

II. CONCLUSIONS OF LAW

The decision in the case at bar was a difficult one for the Court to make--not because the law is unclear, but because the parties to the proceeding offered little, if any, guidance to the Court as to how the case should be resolved. Only two exhibits were entered into evidence: (1) Hitchcock's January 29th deposition[4] and (2) Union Planters Spring 1997 Floor Plan Inventory for Auto Plaza.[5] Neither the Bank's nor Woffard's counsel submitted any case law or support for their respective positions on the issue of dischargeability. The Bank alleged generally that the debt should be excepted from discharge under § 727 and § 523 without citing any specific sections of either of those statutes. Woffard's counsel simply stated that the debt should be discharged because Woffard was innocent.

Despite the parties' inattention to the subject, what is at the heart of this case is the issue of vicarious liability. There was no evidence introduced at the trial which proved Woffard was guilty of any misconduct, therefore, if Auto Plaza's debt to Union Planters is to be excepted from Woffard's discharge, it must be done by imputing Hitchcock's wrongful behavior to Woffard. As mentioned earlier, Union Planters' complaint against Hitchcock was resolved by a consent order prior to trial.

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[4] Copies of the floor plan financing agreements, security agreements, and master notes executed by Auto Plaza were attached to Hitchcock's deposition, as were copies of the "Acknowledgment of Receipt of Title" forms signed by Hitchcock and Woffard.

[5] The floor plan inventory was not explained to the Court, but the Court assumes that the proceeds which Hitchcock wrongfully deposited in Auto Plaza's account came from the sale of the ten vehicles which do not have a "title in" notation next to them.

Although the parties announced that, per this agreement, the debt to the Bank would be excepted from Hitchcock's discharge, they did not state under which subsection of § 523 the exception was being made. As a result, the Court must first decide what Hitchcock is guilty of before deciding the dischargeability of Woffard's debt.

Hitchcock stated in his deposition that he was very clear on the procedure Auto Plaza was to follow when a car was sold: Either he or Woffard would go to the Bank to obtain the title to the car, return to the dealership and collect the money from the customer, and then take the proceeds of the sale to the Bank to pay off the loan. Based on this statement of the procedure, as well as Hitchcock's clear understanding of it, the Court finds that when Hitchcock went to the Bank to obtain the titles for the cars, he made the representation that he had sold the car and would be remitting the proceeds to the Bank as soon as he received them. The Court further finds that the Bank would not have turned the title over to Hitchcock had they known he was not going to remit the proceeds. Based on these findings, the Court concludes that on those occasions when Hitchcock went to the Bank to get the title and then wrongfully deposited the proceeds into Auto Plaza's account, Hitchcock was guilty of making a false representation and/or committing fraud. This conclusion makes Hitchcock's debt non-dischargeable under 11 U.S.C. § 523(a)(2)(A).

Because the Court has found that Hitchcock's debt arose as a result of his fraud, the Court must now determine whether this wrongdoing can be imputed to Woffard. In the case of *BancBoston Mortgage Corp. v. Ledford (In re Ledford)*, 970 F.2d 1556 (6th Cir. 1992), the Sixth Circuit held that the fraudulent conduct of one partner may be imputed to an innocent partner who has no actual knowledge of the fraud if (1) the guilty partner perpetrated the fraud while acting on behalf of the partnership in the ordinary course of business and (2) the innocent partner shared in the monetary benefits of the fraud. *Id.* at 1560. So long as the funds obtained through the partner's fraudulent behavior are not diverted to the wrongdoer's personal use, but are used for partnership purposes, the innocent partner will be said to have shared in the fruits of the fraud. *Id*.

In the case at bar, when Hitchcock went to the Bank to obtain the title for a car, he was acting well within the ordinary course of business and on behalf of the partnership. Both Woffard's trial testimony and Hitchcock's statements in his deposition clearly demonstrate that such procedure was in the normal course of dealing between Auto Plaza and the Bank. Additionally, all of the evidence

introduced at trial proves that the entire amount of the proceeds Hitchcock failed to remit to the Bank were deposited in Auto Plaza's account and were used to pay the partnership's bills. Based on these findings, the Court has no choice but to conclude that, under the Sixth Circuit's precedent in *In re Ledford*, Woffard's debt to Union Planters in non-dischargeable in the amount of $188,499.74.

III. ORDER

It is therefore **ORDERED** that the Complaint to Determine Dischargeability is **GRANTED**. The total amount of $188,499.74 owing to the plaintiff, Union Planters Bank of West Tennessee, by the defendant, Billy G. Woffard, is declared non-dischargeable.

IT IS SO ORDERED.

BY THE COURT,

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G. HARVEY BOSWELL
United States Bankruptcy Judge

Date: August 12, 1998