

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re
DENNIS J. O'CONNOR and
DEBBIE ANN O'CONNOR,
Debtors.

Case No. 01-27039-L
Chapter 7

Congress Financial Corporation,
Plaintiff,

v.

Adv. Proc. No. 01-0862

Dennis J. O'Connor and
Debbie Ann O'Connor,
Defendants.

OPINION

BEFORE THE COURT are (1) the motion of Dennis O'Connor to partially dismiss the Third Amended Complaint and (2) the motion of Debbie Ann O'Connor to dismiss the complaint, or, in the alternative, for judgment on the pleadings. In a previous opinion, the court denied the defendants' motions for judgment on the pleadings with respect to the original complaint filed herein, granted in part the motion of Dennis J. O'Connor for dismissal, granted Dennis J. O'Connor's motion for more definite statement, and granted the motion of Debbie Ann O'Connor to dismiss the complaint without prejudice. Plaintiff Congress Financial Corporation has now filed a Third Amended Complaint and the Trustee has filed a First Amended Complaint, but intends to seek amendment of his complaint to conform it to the Third Amended Complaint of Congress except that the Trustee has not named and will not name Debbie Ann O'Connor as a defendant. Debbie Ann O'Connor has filed an Answer with respect to Congress' Third Amended Complaint. The

complaint of Congress seeks a denial of the discharge of both of the debtors pursuant to 11 U.S.C. §§ 727(a)(2), (3), (4), (5), and (7) or, in the alternative, a nondischargeable money judgment against the debtors pursuant to 11 U.S.C. §§ 523(a)(2), (4), and (6) in an unspecified amount. The court heard oral argument on each of the motions on July 10, 2002. For the reasons set forth below, the court will grant the motion of Dennis J. O'Connor in part, and will treat the motion of Debbie Ann O'Connor as a motion for summary judgment and set a date for Congress to respond. This is a core proceeding. 28 U.S.C. § 157(b)(2)(I) and (J).

I. FACTUAL BACKGROUND

For factual background, please refer to the court's previous opinion, dated March 18, 2002. Following the filing of that opinion, Congress filed its Second Amended Complaint on April 2, 2002, and its Third Amended Complaint on April 10, 2002. The Trustee filed his First Amended Complaint on April 9, 2002. At oral argument, counsel for the Trustee indicated his intention to file a second amendment to conform his complaint to that of Congress but for its allegations that Debbie Ann O'Connor participated in the fraudulent acts complained of. As indicated in the introduction, Debbie Ann O'Connor filed an Answer on May 17, 2002, in which she denies any wrong-doing on her part.

II. ANALYSIS

A. Dennis J. O'Connor's Motion to Partially Dismiss Third Amended Complaint

Dennis J. O'Connor asserts that Congress and the Trustee are impermissibly seeking to assert new claims after the expiration of the statute of limitations which do not relate back to the original complaint. Second, Mr. O'Connor asserts that Congress's proposed section 523(a)(4) claim based on an alleged fiduciary capacity of the debtors is insufficient as a matter of law. Third, Mr. O'Connor asserts that Congress has still failed to plead fraud with sufficient particularity as required by FED. R. BANK. P. 7009. The court will consider each count of the Third Amended Complaint in turn.

1. Count I, Section 727(a)(2)

In the Third Amended Complaint, Congress limits its allegations to those related to a transfer of property by Mr. O'Connor. These allegations are legally sufficient, which is conceded by Mr. O'Connor.

2. Count II, Section 727(a)(3)

Mr. O'Connor asserts that Congress's Third Amended Complaint expands the original allegations of "failure to keep and preserve" inventory records to include allegations of "concealment, destruction, or mutilation" of records. Specifically, Mr. O'Connor complains that the plaintiffs allege misrepresentations in inventory records of Flying "O" Enterprises (hereinafter referred to as "FOE") dating back to 1996 and falsification of FOE financial statements which are

new allegations not mentioned in the original complaint. Mr. O'Connor asserts that Congress has impermissibly pled new facts and that the allegations should be dismissed.

The court disagrees. In its original opinion, the court set forth the elements that must be proved to establish a claim under section 727(a)(3). These are: (1) the debtor had a duty to maintain and keep recorded information; (2) the recorded information has been concealed, destroyed, mutilated, falsified or not kept or preserved; (3) the recorded information is information from which the debtor's present financial condition or business transactions might be ascertained. Congress was directed to plead with more particularity how the alleged falsification of FOE inventory records prevents the Trustee from ascertaining the debtors' current financial condition or past business transactions for a reasonable period of time. This is what Congress has done. In paragraph 15 of the Third Amended Complaint, Congress asserts that all weekly inventory reports delivered to Congress on a weekly basis from 1996 to 2000 were materially false; that Congress used the weekly inventory reports to track the value of FOE's fiber inventory; that fiber inventory was the primary asset of FOE; that stock of FOE was the primary asset of the debtors; that FOE stock was not publicly traded and its value was dependent on the value of the fiber inventory; and the weekly inventory certifications enabled Congress to track the debtors' business transactions as well as track the value of the debtors' primary asset, the FOE stock. In paragraph 34, Congress complains that, as officers of FOE, the debtors had a duty to keep and maintain recorded information of FOE; that the debtors have failed to keep or preserve recorded information from which the debtors' and FOE's

business transactions, including fiber inventory levels of FOE, might be ascertained; that such information was concealed, destroyed, or mutilated by debtors or at the debtors' direction; that the debtors' actions have prevented Congress and the Trustee from ascertaining the debtors' business transactions through FOE during the years from 1996 through 2000; that the information is necessary to determine the extent of the debtors' liability to Congress under the guarantees and further to determine the value of the debtors' interest in the stock of FOE; and that the debtors' actions have prevented Congress and the Trustee from ascertaining the debtors' current financial condition and business transactions. Congress has properly responded to the court's previous instructions by specifying how failure to preserve the inventory records of FOE prevents the Trustee from ascertaining the debtors' financial condition or business transactions. Congress has not relied upon alleged falsification of financial statements in connection with Count II of its complaint and does not appear to be expanding its 727(a)(3) claim beyond that of the original complaint. The allegations of paragraph 19 of the Third Amended Complaint appear to relate to Count VI, a claim under section 523(a)(2), which is based upon Congress' reliance upon false statements in extending or renewing credit to FOE. These allegations are discussed more fully below. The claim of Count II of the Third Amended Complaint arising under section 727(a)(3) appears now to be legally sufficient and the amendment proper.

3. Count III, Section 727(a)(4)

In response to Count III of the Third Amended Complaint, Mr. O'Connor asserts that allegations of false oaths given in connection with this bankruptcy case should be limited to statements related to the fiber inventory of FOE because the original complaint contained only the bare allegation that "Debtors, in furtherance of their scheme to misrepresent the value of Fiber Inventory, have made false oath in this case." In its original opinion, the court directed the plaintiffs to give a more definite statement with respect to the allegation that a false oath had been given in this case, and gave examples of the level of specificity required.^c Congress has complied with the court's direction and the court does not read the allegations of the original complaint as narrowly as Mr. O'Connor suggests it should. The original complaint put Mr. O'Connor on notice that Congress asserted that he and his wife had given false oaths in this bankruptcy case. The court does not read the introductory phrase "in furtherance of their scheme to misrepresent the value of fiber inventory," to mean that the false oaths related only to misrepresentation of the fiber inventory, but rather that the bankruptcy case itself furthered the debtors' scheme because a discharge in bankruptcy would in effect shield the debtors from liability for their alleged misrepresentations. The court directed the plaintiffs to specify what oaths of the debtors were false and how those oaths were false. Paragraphs 38 through 40 of the Third Amended Complaint do this with the appropriate level of specificity and do not introduce new claims which were not asserted in the original complaint.

4. Count IV, Section 727(a)(5)

In response to Count IV of the Third Amended Complaint, Mr. O'Connor asserts that Congress has made new allegations concerning diminution in value of the FOE stock and fails to allege that the debtors were ever asked to explain losses or deficiencies in assets. Although Congress's original complaint related only to diminution in the value of fiber inventory, the Trustee's original complaint alleged diminution in value of the FOE stock. Mr. O'Connor was thus put on notice concerning how the loss in value of the fiber inventory related to loss in value of his own assets, and it is fair to assume that even with respect to Congress's original complaint, Mr. O'Connor could fairly well ascertain the direction of Congress's allegation given the fact that fiber inventory appears to have been the primary asset of FOE, and FOE stock appears to have been the primary asset of the debtors. Mr. O'Connor's complaint that he has never been asked to explain the loss of assets is vacuous. The filing of the complaint itself constitutes a request to explain the loss. Mr. O'Connor's answer will explain any loss in the value of the stock, or if it does not, may serve as the basis for denying his discharge. *See Hawley v. Cement Industries, Inc. (In re Hawley)*, 51 F.3d 246, 249 (11th Cir. 1995).

5. Count V, Section 727(a)(7)

In response to Count V of the Third Amended Complaint, Mr. O'Connor asserts that Congress has asserted a number of new allegations not raised in the initial complaint and that these allegations are time-barred. The original complaint alleged that "Debtors committed acts prohibited

by 11 U.S.C. § 727(a)(2)-(5) in connection with the bankruptcy case of FOE within one year of the filing of the petition.” In the court’s prior opinion, the plaintiffs were given the opportunity to re-plead setting forth with particularity the acts alleged to have been taken by the debtors in connection with the bankruptcy case of FOE. Congress has done this, essentially alleging that Mr. O’Connor gave false oaths in connection with the bankruptcy case of FOE, failed to keep or preserve fiber inventory records of FOE, destroyed fiber inventory records of FOE, and failed to explain the loss of value of FOE’s fiber inventory. The original complaint alleged unspecified acts taken in connection with the bankruptcy case of FOE. The amended complaint specifies those acts, and those arise out of the same conduct complained of in the original complaint.

In addition, Mr. O’Connor complains that allegations of failure to keep or preserve fiber inventory records should be dismissed based on the court’s prior ruling with respect to the plaintiffs’ claims under section 727(a)(2). Count V of the Third Amended Complaint arises under section 727(a)(7). Congress need not match prohibited conduct with specific subsections of section 727 in order to state a claim under section 727(a)(7).

6. Count VI, Section 523(a)(2)(A) and (B)

Mr. O’Connor complains that the allegations of Count VI of the complaint have been expanded to false statements in writing concerning FOE’s financial condition where the original complaint alleged only false statements concerning the debtors’ financial condition. In fact, the original complaint contained numerous allegations concerning false statements of FOE’s financial

condition, specifically false statements of FOE's inventory quality. The court has reviewed the exhibits offered by Congress in connection with the Third Amended Complaint and is satisfied that each of the documents relates to the conduct complained of in the original complaint. Section 523(a)(2)(B) specifically includes false statements concerning the debtor's or an insider's financial condition.

7. Count VII, Section 523(a)(4)

Mr. O'Connor correctly notes that Congress failed to plead fraud or defalcation while acting in a fiduciary capacity in its original complaint. The Third Amended Complaint describes a trust implied at law arising from the alleged insolvency of FOE. As stated in the earlier opinion, section 523(a)(4) requires the existence of an express trust. Congress has failed to plead the existence of an express trust. Further, Congress re-alleges that the mere payment of salaries and other benefits to the officers of FOE constituted embezzlement. Embezzlement requires a fraudulent, and therefore unlawful, appropriation of funds entrusted to a person. Congress has not pled that the payment of salaries or related benefits was unlawful. Rather, its allegations tend to show that it would not have loaned funds to FOE had it known the true quality and nature of the fiber inventory of FOE. This does not state a cause of action for embezzlement, and Count VII of the Third Amended Complaint should be dismissed.

**B. Debbie Ann O'Connor's Motion to Dismiss Third Amended Complaint,
or in the Alternative, for Judgment on the Pleadings**

As noted previously, although Mrs. O'Connor filed a motion to dismiss or in the alternative, for judgment on the pleadings, she also filed an answer to the Third Amended Complaint. Thus, the court elects to treat her motion as a motion for summary judgment and give Congress an opportunity to respond with appropriate supporting affidavits containing specific allegations concerning Mrs. O'Connor's activities. Congress will be given thirty days from the entry of this order to respond.

III. CONCLUSION

For the foregoing reasons, the motion of Dennis J. O'Connor to partially dismiss the Third Amended Complaint is granted in part and denied in part. Count VII of the Third Amended Complaint will be dismissed as to both Mr. and Mrs. O'Connor. The remaining counts are legally sufficient and do not impermissibly introduce new facts barred by applicable statutes of limitation.

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Opinion

The motion of Debbie Ann O'Connor will be treated as a motion for summary judgment. The court will enter separate orders consistent with this opinion

BY THE COURT,

JENNIE D. LATTA
United States Bankruptcy Judge

Dated: July 25, 2002

cc: Debtors
Attorney for Debtors
Plaintiff
Attorney for Plaintiff
Chapter 7 Trustee
Attorney for Chapter 7 Trustee