



Dated: July 30, 2019
The following is ORDERED:

A handwritten signature in cursive script that reads "Jennie D. Latta".

Jennie D. Latta
UNITED STATES BANKRUPTCY JUDGE

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION**

In re
LARRY PARKE CHINN,
Debtor.

Case No. 17-30912-L
Chapter 7

PACIFIC LIFE INSURANCE COMPANY,
Plaintiff,

v.
LARRY PARKE CHINN,
Defendant.

Adv. Proc. No. 18-00153

ORDER DENYING MOTION TO DISMISS

BEFORE THE COURT is the motion of Defendant Larry Parke Chinn (“Chinn”) to dismiss this proceeding pursuant to Federal Rule of Civil Procedure 12(b)(6) made applicable in bankruptcy by Federal Rule of Bankruptcy Procedure 7012(b). Plaintiff Pacific Life Insurance Company (“Pacific Life” or the “Company”) has filed a response in opposition to the motion and Chinn has filed a reply. The court heard oral argument on July 18, 2019. Chinn is represented by

attorneys Michael P. Coury and Ricky L. Hutchens of Glankler Brown, PLLC. Pacific Life is represented by attorneys Shepherd D. Tate and Michael P. Kapellas of Bass, Berry & Sims, PLC.

BACKGROUND

Pacific Life commenced this adversary proceeding on June 29, 2018, seeking a nondischargeable judgment against Chinn in the amount of \$10,842,918.76, representing unearned commissions on sales of life insurance policies, pursuant to 11 U.S.C. §§ 523(a)(2), (a)(4), and (a)(6); and 11 U.S.C. § 727(a)(4). Chinn filed a motion for judgment on the pleadings, which, after briefing and argument, was conditionally granted giving Pacific Life leave to file an amended complaint. Adv. Proc. Dkt. No. 33.

Pacific Life filed its First Amended Complaint to Determine Dischargeability on April 8, 2019 (the “Amended Complaint”). It asks for a nondischargeable judgment in the amount of \$10,842,918.76, pursuant to 11 U.S.C. §§ 523(a)(2) and (a)(6). Adv. Proc. Dkt. No. 36.

Chinn filed his motion to dismiss the Amended Complaint on May 8, 2019. Pacific Life filed a timely response on June 5, 2019, and Chinn filed his reply on July 15, 2019.

The Amended Complaint alleges that Chinn entered into a contract with Pacific Life on September 1, 1992, pursuant to which Chinn agreed to act as “producer” by selling Pacific Life’s insurance products and Pacific Life agreed to compensate him for those sales (the “Contract”). The Amended Complaint further alleges that the Contract required that the producer comply with the underwriting and issue requirements of Pacific Life and applicable insurance laws and regulations of the state or states in which Chinn operated. Such laws and regulations, it says, include prohibitions of rebating practices.

The Amended Complaint alleges that Pacific Life paid Chinn commissions on insurance sales that were deemed to have been earned if the policy continued in effect for a specified period

ranging from thirty-five to forty-eight months (the “Chargeback Period”). When policies were surrendered prior to the expiration of the Chargeback Period, unearned commissions were to be repaid to Pacific Life by the producer.

The Amended Complaint alleges that during the period between 2007 and 2011, a significant portion of the commissions Chinn received from Pacific Life were procured by fraud. It alleges that in an undetermined number of cases, the premiums on policies sold by Chinn were financed through a third-party lender who agreed to make premium payments on behalf of the policyholder. In these cases, the Amended Complaint alleges, Chinn rather than the policyholder made the payments to the premium finance lender by way of a rebate. It alleges that this practice continued until the Chargeback Period expired which enabled Chinn to receive and retain the full commission on the sales of those policies. The Amended Complaint alleges that “Chinn created and effected this ruse for the purpose of defrauding Pacific Life of the amount of the front-loaded commissions.” Amended Complaint, Adv. Proc. Dkt. No. 36, ¶ 13.

The Amended Complaint then sets out ten examples of policies sold by Chinn to various persons identified by their initials. In each case, the Amended Complaint identifies the face amount of the policy, the apparent representation or agreement Chinn made with the policyholder to induce the purchase of the policy, the length of time that Chinn financed the premium payments, and the commission paid to Chinn by Pacific Life, which the Amended Complaint describes as “fraudulently generated.”

The Amended Complaint alleges that Chinn concealed from Pacific Life the true nature of the policies including the facts that he was causing the premiums to be paid and that the policies were likely to be surrendered at or near the first possible date at which Chinn could retain the commissions paid to him.

The Amended Complaint alleges that Pacific Life filed suit against Chinn in the Chancery Court of Shelby County, Tennessee, on March 14, 2012, seeking repayment of commissions that Chinn had collected on policies that had been surrendered, and later filed an amended complaint in the same court on November 16, 2017. The Amended Complaint alleges that Chinn filed his voluntary petition under Chapter 7 of the Bankruptcy Code on December 13, 2017, preventing Pacific Life from proceeding to judgment.

With respect to section 523(a)(2) of the Bankruptcy Code, the Amended Complaint alleges that Chinn intentionally engaged in a fraudulent scheme to defraud Pacific Life of insurance commissions under false pretenses, made false representations to Pacific Life and engaged in actual fraud. Specifically, the Amended Complaint alleges that Chinn induced individuals to purchase high-value insurance policies while secretly arranging to have the premiums paid or financed without the knowledge of Pacific Life.

With respect to section 523(a)(6) of the Bankruptcy Code, the Amended Complaint alleges that Chinn caused willful and malicious injury to Pacific Life and/or to the property of Pacific Life by defrauding Pacific Life of the commissions he collected.

Pacific Life seeks a money judgment representing the amount of the commissions paid to Chinn pursuant to his alleged fraud, and that the judgment be declared to be nondischargeable pursuant to 11 U.S.C. §§ 523(a)(2) and/or 523(a)(6).

THE MOTION TO DISMISS

Chinn argues that the Amended Complaint should be dismissed pursuant to Federal Rule of Civil Procedure 12(b)(6) because it fails to state a claim upon which relief can be granted. Specifically, Chinn asserts that:

- (1) The allegations of fact made in support of the section 523(a)(2)(A) claim are conclusory or otherwise insufficient. Motion to Dismiss, Adv. Proc. Dkt. No. 39, p. 13.
- (2) The examples of fraudulently generated policies given in the Amended Complaint lack specificity. Motion to Dismiss, Adv. Proc. Dkt. No. 39, p. 14.
- (3) The examples of fraudulently generated policies given in the Amended Complaint are not representative. Motion to Dismiss, Adv. Proc. Dkt. No. 39, p. 15.
- (4) The damages sought by Pacific Life in the Amended Complaint arise from an alleged breach of contract, not from fraud. Motion to Dismiss, Adv. Proc. Dkt. No. 39, p. 16.
- (5) The claim that Chinn perpetrated “an unlawful rebating scheme” does not state a claim under section 523(a)(2)(A) because there is no private right of action under Tennessee Code Annotated section 56-8-104(8) (which prohibits “as an inducement to the policy, any rebate of premiums payable on the policy, or any special favor or advantage in the dividends [or] other benefits thereon, or any valuable consideration or inducement whatever not specified in the policy....”). Motion to Dismiss, Adv. Proc. Dkt. No. 39, p. 17.
- (6) With respect to the individual example policies, the Amended Complaint does not plead fraud with particularity as required by Federal Rule of Civil Procedure 9(b). Motion to Dismiss, Adv. Proc. Dkt. No. 39, pp. 17-21.
- (7) The Amended Complaint does not sufficiently plead tortious activity beyond mere breach of contract in support of the section 523(a)(6) claim. Motion to Dismiss, Adv. Proc. Dkt. No. 39, p. 23.

- (8) The Amended Complaint does not sufficiently plead willful and malicious injury in support of the section 523(a)(6) claim. Motion to Dismiss, Adv. Proc. Dkt. No. 39, p. 23.

DISCUSSION

The basic pleading standard applicable to this adversary proceeding is set out at Federal Rule of Civil Procedure 8 made applicable in bankruptcy by Federal Rule of Bankruptcy Procedure 7008. Rule 8 provides:

- (a) Claims for Relief. A pleading that states a claim for relief must contain:
- (1) a short and plain statement of the grounds for the court’s jurisdiction, unless the court already has jurisdiction and the claim needs no new jurisdictional support;
 - (2) a short and plain statement of the claim showing that the pleader is entitled to relief; and
 - (3) a demand for the relief sought, which may include relief in the alternative or different types of relief.

In addition, “[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or misstate,” “while, “[m]alice, intent, knowledge, and other conditions of a person’s mind may be alleged generally.” Fed. R. Civ. P. 9(b), made applicable by Fed. R. Bankr. P. 7009.

To survive a motion under Rule 12(b)(6), “a complaint must contain sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). The court is directed first to identify allegations that are “no more than conclusions, [and thus] are not entitled to the assumption of truth,” and then to determine whether the allegations that are well pled “plausibly give rise to an entitlement to relief.” *Iqbal*, 556 U.S. at 679.

The Section 523(a)(2)(A) Claim

Bankruptcy Code section 523(a)(2)(A) excepts from discharge those debts “for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s ... financial condition.” 11 U.S.C. § 523(a)(2)(A). As Judge Richard Posner once observed:

No learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentations and misleading omissions. “Fraud is a generic term, which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by the suppression of truth. No definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated.” *Stapleton v. Holt*, 207 Okla. 443, 250 P.2d 451, 453-54 (Okla. 1952).

McClellan v. Cantrell, 217 F.3d 890, 893 (7th Cir. 2000); *see also Mellon Bank v. Vitanovich (In re Vitanovich)* 259 B.R. 873, 877 (B.A.P. 6th Cir. 2001) (adopting the position of the Seventh Circuit that actual fraud as used in 11 U.S.C. § 523(a)(2)(A) is not limited to misrepresentations and misleading omissions.) “When a debtor intentionally engages in a scheme to deprive or cheat another of property or a legal right, that debtor has engaged in actual fraud and is not entitled to the fresh start provided by the Bankruptcy Code.” *Vitanovich*, 259 B.R. at 877. “Although ‘fraud’ connotes deception or trickery generally, the term is difficult to define more precisely.” *Husky Int’l Electronics, Inc. v. Ritz*, ___ U.S. ___, 136 S. Ct. 1581, 1586 (2016). As the *Husky Int’l* Court explains:

“Actual fraud” has two parts: actual and fraud. The word “actual” has a simple meaning in the context of common-law fraud: It denotes any fraud that “involv[es] moral turpitude or intentional wrong.” *Neal v. Clark*, 95 U.S. 704, 709, 24 L. Ed. 586 (1878). “Actual” fraud stands in contrast to “implied” fraud or fraud “in law,” which describe acts of deception that “may exist without the imputation of bad faith or immorality.” *Ibid.* Thus, anything that counts as “fraud” and is done with wrongful intent is “actual fraud.”

Id. at 1586. In contrast to false pretenses or false representation, actual fraud does not require a misrepresentation or reliance by a creditor on an action taken by the debtor. *Husky Int'l*, 136 S. Ct. at 1587. Instead, a “creditor must prove that (1) the debtor perpetrated a fraud against a creditor; (2) the debtor acted with intent to defraud; and (3) the creditor sustained loss or damage as a proximate cause of the fraud.” *Taylor v. Demopoulos (In re Demopoulos)*, 2008 WL 4489153, at *8 (Bankr. N.D. Ill., Sept. 23, 2008) (citing *McClellan*, 217 F.3d at 893-94).

In its essence, the Amended Complaint alleges that Chinn fraudulently induced Pacific Life to pay commissions to him based upon the sale of life insurance policies obtained by representing to potential policy holders that that they would not be responsible for paying the premiums without disclosing to Pacific Life (a) the misrepresentations made to induce the policy holders to purchase their policies, and (b) the fact that it was Chinn himself who would pay the premium finance payments for so long as necessary to avoid a commission chargeback. The Amended Complaint asserts that under these circumstances, it is entitled to a refund of all commissions paid to Chinn, and that Chinn’s obligation to repay commissions should survive discharge in bankruptcy. The Amended Complaint gives ten examples of such policies identified by the policy holder, face amount of policy, length of time before surrender, and commission received and retained. The Amended Complaint alleges that these ten examples are “believed to be typical of the way Chinn ‘sold’ many other policies” and provides a chart showing that 75% of the 88 policies Chinn sold through Pacific Life in 2007 and 2008 were surrendered after the Chargeback Period expired enabling Chinn to retain the full commission paid to him. Amended Complaint, Adv. Proc. Dkt. No. 36, p. 9.

These allegations are more than adequate to put Chinn on notice of the claims being made against him and adequately describe the fraudulent scheme whereby Chinn was able to receive and

retain commissions in excess of those to which he would otherwise be entitled. The Amended Complaint gives ten specific examples of policies written pursuant to the alleged scheme. These are pled with sufficient particularity to put Chinn on notice of the claims against him. The Amended Complaint alleges that both Chinn's Contract and Tennessee insurance regulations prohibited the type of rebating that he engaged in, labeling it an unfair trade practice. It is not necessary that the insurance regulations give rise to a private right of action for the fact of their violation to show evidence of fraud because the Amended Complaint alleges that Chinn concealed the truth concerning his practices from Pacific Life. The logical inference to be drawn from the allegations concerning concealment of violations of the Contract and insurance regulations is that the policies would not have been written had Pacific Life known the truth. The Amended Complaint narrows the universe of potentially fraudulently induced commissions to those earned with respect to policies written through Pacific Life between 2007 and 2011, stating as an example that "more than 75% of the 88 policies Chinn 'sold' through Pacific Life in 2007 and 2008 were surrendered after being in force for between 36 and 47 months, the precise range of time necessary for the Chargeback Period to expire so that Chinn could retain the fraudulently generated commissions." Amended Complaint, Adv. Proc. Dkt. No. 36, ¶ 15. Pacific Life has adequately described a fraud perpetrated on Pacific Life.

The Amended Complaint includes allegations of fact tending to show that Chinn knew what he was doing and acted with intent to defraud. As stated above, the Amended Complaint alleges that Chinn caused insurance premiums to be paid or financed just long enough to maximize the commissions that he could retain. The Amended Complaint describes a number of different ruses that Chinn used to induce persons to become policyholders. The Amended Complaint alleges

that Chinn concealed the true nature of the policies from Pacific Life. All of these allegations, when taken as true, tend to show that Chinn acted with intent to defraud.

The Amended Complaint alleges that Pacific Life sustained a loss as a result of Chinn's fraud. Specifically, the Amended Complaint alleges that Chinn was able to generate and retain more than \$10,000,000 in commissions paid by Pacific Life, commissions to which he would not have been entitled but for his fraudulent conduct.

The Amended Complaint states a claim for relief under section 523(a)(2)(A).

The Section 523(a)(6) Claim

Bankruptcy Code section 523(a)(6) excepts from discharge a debt "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). Where fraud is alleged, it is sometimes difficult to distinguish causes of action contemplated under section 523(a)(2) from those under section 523(a)(6). One of the main differences is the measure of recovery. For section 523(a)(2) claims, the measure of recovery is the money, property, services, or other benefits received by the debtor. For section 523(a)(6) claims, the measure of recovery is the damage sustained by another entity. *See ITT Life Ins. Corp. v. Haakenson (In re Haakenson)*, 159 B.R. 875, 887 (Bankr. D. N.D. 1993). The situations that may give rise to a cause of action under section 523(a)(6) are much broader than those that may give rise to a cause of action under section 523(a)(2). *Id.* "[Section] 523(a)(6) covers debts for 'willful and malicious injury,' whether or not that injury is the result of fraud ..., whereas § 523(a)(2)(A) covers only fraudulent acts." *Husky Int'l Electronics*, 136 S. Ct. at 1588. The measure of damages under section 523(a)(2) is the value of the money, property, services, or benefits obtained by the debtor. The measure of damages under section 523(a)(6) is the damages sustained by the other entity. *Id.*

Section 523(a)(6) requires proof of a willful and malicious injury. “The word ‘willful’ in (a)(6) modifies the word ‘injury,’ indicating that nondischargeability takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury.” *Kawaauhau v. Geiger*, 523 U.S. 57, 62, 118 S. Ct. 974, 977 (1998). The debtor must have intended the consequences of his acts, not simply the acts themselves. *Id.* Section 523(a)(6) brings to mind the category of intentional torts, which are defined as “those motivated by a desire to inflict injury or those substantially certain to result in injury.” *Markowitz v. Campbell (In re Markowitz)*, 190 F.3d 455, 464 (6th Cir. 1999) (citing Restatement (Second) of Torts § 8A, at 15 (1964)).

The Amended Complaint alleges that Chinn perpetrated the fraudulent scheme described above knowing that injury to Pacific Life was substantially certain to result. It alleges that “Chinn caused a willful and malicious injury to Pacific Life and/or to the property of Pacific Life through, among other things, defrauding Pacific Life of the commissions he collected through his sale of insurance policies.” Amended Complaint, Adv. Proc. Dkt. No. 36, ¶ 28. While Pacific Life does not distinguish a separate injury to Pacific Life beyond commissions it would otherwise not have paid, it is not necessary that it do so. Section 523(a)(6) may overlap section 523(a)(2)(A) when actual fraud is alleged.

Chinn argues that the Amended Complaint does not sufficiently plead tortious activity beyond mere breach of contract in support of the section 523(a)(6) claim. To the contrary, the Amended Complaint alleges ten separate examples with detailed facts that take policies written by Chinn outside “mere breach of contract.” None of the policies described in the complaint can be said to have arisen in the ordinary course of business. Instead, the Amended Complaint alleges that Chinn conducted a complex and far reaching scheme to defraud Pacific Life of commissions to which he would not have been entitled had the true state of the policies been revealed. The loss

to Pacific Life did not result from Chinn's mere failure to repay unearned commissions, but from his scheme to induce Pacific Life to pay commissions it would not have paid had it known the true underlying facts.

The allegations of the Amended Complaint adequately state a claim for relief under section 523(a)(6).

CONCLUSION

For the foregoing reasons, the Motion to Dismiss this adversary proceeding is **DENIED**.

cc: Debtor/Defendant
Attorneys for Debtor/Defendant
Plaintiff
Attorneys for Plaintiff
Chapter 7 Trustee