

Dated: October 13, 2011
The following is ORDERED:



Jennie D. Latta

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UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re
CHARLES WAYNE ALEXANDER and
PATRICIA McNATT ALEXANDER,
Debtors.

Case No. 10-32756-L
Chapter 7

BBC Holding, Inc.,
Plaintiff,

v.
Charles Wayne Alexander and
Patricia McNatt Alexander,
Defendants.

Adv. Proc. No. 11-00062

ORDER CONDITIONALLY GRANTING DEFENDANTS' MOTION TO DISMISS

BEFORE THE COURT is a second motion to dismiss the complaint filed by the Defendants, Charles Wayne Alexander and Patricia McNatt Alexander (Dkt. No. 30), and the Plaintiff's response thereto (Dkt. No. 33). This motion seeks to dismiss the complaint for failure to state a claim upon which relief can be granted pursuant to Federal Rule of Civil Procedure 12(b)(6), made applicable in bankruptcy by Federal Rule of Bankruptcy Procedure 7012(b). The complaint asks the court to

determine that a judgment debt owed by the Defendants to the Plaintiff, BBC Holding, Inc., is excepted from discharge pursuant to 11 U.S.C. §§ 523(a)(2), (4), or (6).

Jurisdiction over a complaint arising under the Bankruptcy Code lies with the district court. 28 U.S.C. § 1334(b). Pursuant to authority granted to the district courts at 28 U.S.C. § 157(a), the district court for the Western District of Tennessee has referred to the bankruptcy judges of this district all cases arising under title 11 and all proceedings arising under title 11 or arising in or related to a case under title 11. *In re Jurisdiction and Proceedings Under the Bankruptcy Amendments Act of 1984*, Misc. No. 81-30 (W.D. Tenn. July 10, 1984). The determination of the dischargeability of a particular debt is a core proceeding arising under the Bankruptcy Code. *See* 11 U.S.C. § 157(b)(2)(I). Accordingly, I have authority to hear and determine this adversary proceeding subject to appellate review under section 158 of title 11. 28 U.S.C. § 157(b)(1).

I.

Federal Rule of Civil Procedure 8(a), made applicable in bankruptcy proceedings by Federal Rule of Bankruptcy Procedure 7008(a), directs that a pleading provide “a short and plain statement of the claim showing that the pleader is entitled to relief.” In deciding a motion under Rule 12(b)(6), the court must “construe the complaint in the light most favorable to the plaintiff, accept its allegations as true, and draw all reasonable inferences in favor of the plaintiff.” *Directv, Inc. v. Treesh*, 487 F.3d 471, 476 (6th Cir. 2007). Legal conclusions, however, are not entitled to an assumption of truth. *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009). The defendant has the burden to prove that the plaintiff has failed to state a claim for relief. *Directv*, 487 F.3d at 476.

In *Iqbal*, the Court articulated two “working principles” for determining whether a complaint may survive a motion to dismiss. First, the tenet that the court must accept as true all of the

allegations contained in a complaint is inapplicable to legal conclusions. Second, only a complaint that states a plausible claim for relief survives a motion to dismiss. *Iqbal*, 129 S. Ct. at 1949-50, citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555-56, 127 S. Ct. 1955 (2007). “[W]here the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged – but it has not shown – that the pleader is entitled to relief.” *Iqbal*, 129 S. Ct. at 1950 (brackets omitted).

II.

The complaint contains the following well-pleaded factual allegations:

5. Defendants have executed certain promissory notes payable to the order of Oakland Deposit Bank.
6. Oakland Deposit Bank assigned all its rights to BBC.
7. Defendants have failed to make payments and/or have deficiencies for foreclosed properties totaling One Million Nine Hundred Thirty One Thousand One Hundred One Dollars (\$1,931,101.00).
8. The Debtors obtained the loans subject to the Promissory Notes through fraudulent means. Debtors made assurances to the bank that they never intended to keep. These assurances included that the proceeds from the loans would go in part to restoring properties secured by the deeds of trust. That Debtors never intended to restore said properties, instead used the money obtained to purchase additional property and to fund their lavish lifestyle.
9. BBC filed suit against Defendants in Shelby County, Tennessee on August 31, 2009, to collect certain amounts owed to BBC. In its Complaint, BBC alleged that Defendants “have fraudulently been converting rents of properties that are subject of the Promissory Notes.” See Complaint attached hereto as Exhibit A. Defendants have failed to make payments of these rentals to Plaintiff and fraudulently converted them to themselves totaling approximately One Hundred Twenty-Eight Thousand Dollars (\$128,000.00).
10. That on November 23, 2009, judgment was entered against the Debtors in the Circuit Court for Fayette County, Tennessee, on the Complaint. A copy of the Order is attached hereto as Exhibit B.

Complaint, Dkt. No. 1

I have reviewed the complaint and order filed in the Circuit Court for Fayette County, Tennessee at Somerville, No. 5371 (the “Somerville Complaint” and “Somerville Order”). The Somerville Complaint alleges in Count I that the defendants (Charles W. Alexander and Patricia M. Alexander) failed to make payments and/or have deficiencies for foreclosed properties in the amount of \$1,931,101.00. There is no mention of fraud with respect to Count I of the Somerville Complaint. Count II of the Somerville Complaint alleges that the defendants fraudulently converted rents of properties that are subject of the promissory notes. It alleges that the defendants failed to pay over these rentals to the plaintiff (BBC Holding, Inc.), and fraudulently converted them to themselves totaling approximately \$128,000.00. The Somerville Order recites that the defendants failed to answer or appear, and establishes judgment for the plaintiff in the amount of \$2,059,101.00, together with attorney fees in the amount of \$500,000.00, and costs.¹ There is no mention of fraud or conversion in the Somerville Order.

BBC Holding claims that it is entitled to judgment in this adversary proceeding based upon the Somerville Order. It says that a Tennessee court would afford the Somerville Order preclusive effect and that collateral estoppel bars relitigation of issues within the complaint. Plaintiff BBC Holding, Inc’s Response to Defendants’ Motion to Dismiss for Failure to State a Claim, Dkt. No. 33. The Plaintiff provides no authority in support of its position.

A.

¹ I note that, on the assumption that the rents were to be paid over to the Plaintiff in order to reduce the balances due on the promissory notes, the judgment appears to double count the rents that were not paid over.

Count I of the complaint asks that the debt to BBC Holding be excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A). Section 523(a)(2)(A) excepts from discharge “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 or an insider’s financial condition.” The complaint contains the following additional statement in support of Count I:

13. The Debtors/Defendants through false pretenses, false representations, and/or actual fraud, with the intent to deceive, acted to induce BBC to extend credit to Debtors/Defendants. BBC relied upon these false pretenses, false statements and actual fraud by the Debtors/Defendants causing BBC to extend credit to them. BBC would not have extended credit to Defendants/Debtors if not for the false representations. BBC avers as a proximate result of the acts of the Debtors/Defendants as alleged above, BBC has suffered substantial damages. The Debtors/Defendants’ conduct violates 11 U.S.C. Section 523(a)(2)(A) and said debt should be declared nondischargeable.

Dkt. No. 1. The Plaintiff has pleaded, but has not shown, that it is entitled to relief. In the first place, it contradicts itself in pleading first that the loans to the Defendants were extended by Oakland Deposit Bank and then assigned to BBC Holding, and then that the Defendants made false statements to BBC Holding that it relied upon in extending credit. The promissory notes have not been made a part of the record in this bankruptcy proceeding. The Plaintiff relies solely on the Somerville Order to prove the debt owed to it, but according to BBC Holding, it was Oakland Deposit Bank that extended credit, not BBC Holding. Thus, BBC Holding could not have relied upon any statements by the Defendants.

In the second place, the allegations concerning fraudulent statements that induced the extension of credit are merely conclusory. They are completely lacking in any specificity concerning who made statements, to whom, on what date and at what time, and of what nature.

Federal Rule of Civil Procedure 9(b), made applicable in adversary proceedings by Federal Rule of Bankruptcy Procedure 7009(b), specifies that “[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake....[but] [m]alice, intent, knowledge, and other conditions of a person’s mind may be alleged generally.”

In the third place, the complaint fails to allege facts addressing each of the elements of section 523(a)(2)(A). In order to have a debt declared nondischargeable based upon a false representation under section 523(a)(2)(A), a creditor must prove the following elements: (1) the debtor obtained money through a material misrepresentation that, at the time, the debtor knew was false or made with gross recklessness as to its truth; (2) the debtor intended to deceive the creditor; (3) the creditor justifiably relied on the false misrepresentation; and (4) its reliance was the proximate cause of the loss. *Livingston v. Transnation Title Ins. Co. (In re Livingston)*, 372 Fed. Appx. 613, 618 (6th Cir. 2010), citing *Rembert v. AT&T Universal Card Servs., Inc. (In re Rembert)*, 141 F.3d 277, 280-81 (6th Cir. 1998). The complaint is silent with respect to these elements.

At best, the complaint vaguely alleges that the Defendants made promises to their lender concerning the intended use of loan proceeds. The complaint states that the Defendants made assurances “that the proceeds from the loans would go in part to restoring properties secured by the deeds of trust,” and that “Debtors never intended to restore said properties, instead used the money obtained to purchase additional property and to fund their lavish lifestyle.” Evidence of fraud in the inducement may be introduced by parol evidence, but fraud in the inducement involves “a fraudulent misstatement of *fact* that induces a party to enter a contract, not a fraudulent promise of future performance that is within the scope of the subject matter of the written contract but was not included in it.” *Watkins & Son Pet Supplies v. Iams Co.*, 254 F.3d 607, 613 (6th Cir. 2001). The

complaint does not include copies of the promissory notes or loan agreements that form the basis of the judgment awarded to BBC Holding. The “facts” that BBC Holding relies upon are nothing more than promises concerning the use of the loan proceeds. If the use of the proceeds was restricted in any way, that restriction should have been made part of the written agreements between the parties. If they were, then BBC Holding’s action is one for breach of contract, not for fraud.

BBC Holding has failed to allege facts sufficient to support its claims under section 523(a)(2)(A) of the Bankruptcy Code.

B.

Count II of the complaint seeks a determination that the debt owed to BBC Holding is nondischargeable pursuant to 11 U.S.C. § 523(a)(4). That section prevents discharge of any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny. In order to recover for fraud or defalcation while acting in a fiduciary capacity, a plaintiff must show by a preponderance of the evidence: (1) a pre-existing fiduciary relationship, (2) a breach of that relationship, and (3) resulting loss. *Patel v. Shamrock Floorcovering Servs., Inc. (In re Patel)*, 565 F.3d 963, (6th Cir. 2009), citing *Bd. of Trustees v. Bucci (In re Bucci)*, 493 F.3d 635, 642 (6th Cir. 2007). To support this claim, the complaint states:

15. The Debtors/Defendants engaged in fraud or defalcation while acting in a fiduciary capacity, and in the absence of said fraud of [sic] defalcation while acting in a fiduciary capacity BBC would not have incurred the losses attributable to the Defendants/Debtors. The Debtors/Defendants conduct violates 11 U.S.C. Sections 523(a)(4) and said debt to BBC shall be declared nondischargeable.

Dkt. No. 1. The complaint contains no factual allegations tending to establish a fiduciary relationship between the Defendants and the Plaintiff. To the contrary, the factual allegations of the complaint tend to establish a relationship of borrower and lender. “The dealings between a lender

and borrower are not inherently fiduciary absent special facts and circumstances.” *Oak Ridge Precision Inds., Inc. v. First Tennessee Nat’l Assn*, 835 S.W.2d 25, 30 (Tenn. Ct. App. 1992). Moreover, recovery under section 523(a)(4) requires proof of an express trust. The Sixth Circuit has limited the application of section 523(a)(4) to express or technical trusts, and has refused to extend it to constructive or implied trusts. *Bucci*, 493 F.3d at 640. The complaint contains no allegation tending to show the presence of an express trust. Nor does it mention embezzlement or larceny. “A creditor proves embezzlement by showing that he entrusted his property to the debtor, the debtor appropriated the property for a use other than that for which it was entrusted, and the circumstances indicate fraud.” *Bucci*, 493 F.3d at 644, quoting *Brady v. McAllister (In re Brady)*, 101 F.3d 1165, 1173 (6th Cir. 1996). To establish the common law crime of larceny, “the government is required to establish a wrongful taking and carrying away of property with the fraudulent intent to deprive the owner of his property without his consent.” *U.S. v. Hall*, 549 F.3d 1033, 1040 (6th Cir. 2008). The complaint is bereft of any allegations that would establish a cause of action under section 523(a)(4).

C.

Count III of the complaint alleges that the debt owed to BBC Holding by the Defendants is nondischargeable pursuant to 11 U.S.C. § 523(a)(6). That section excepts from discharge debts for willful and malicious injury by the debtor to another entity or to the property of another entity. In support of its section 523(a)(6) claim, BBC Holding alleges that:

18. The injury to BBC caused by Debtors/Defendants was deliberate or intentional, with the Debtors/Defendants either intending the resulting injury or intentionally taking the action that Debtors/Defendants knew or were substantially certain to cause injury.

Dkt. No. 1. For the section 523(a)(6) exception to apply, a debtor must (1) “will or desire harm,” or (2) “believe that injury is substantially certain to occur as the result of his behavior.” *Muselli v. Droomers (In re Muselli)*, 379 Fed. Appx. 494, 498 (6th Cir. 2010), quoting *Markowitz v. Campbell (In re Markowitz)*, 190 F. 3d 455, 465 n.10 (6th Cir. 1999). The only factual allegations remotely supporting this claim are those concerning the Defendants’ unauthorized use of rents. Among the types of conduct that will satisfy the willful and malicious injury standard are intentional infliction of emotional distress, malicious prosecution, conversion, assault, false arrest, intentional libel, and deliberately vandalizing the creditor’s premises. *Steier v. Best (In re Best)*, 109 Fed. Appx. 1, 5, n.2 (6th Cir. 2004). The standard is a stringent one, and “debts arising from recklessly or negligently inflicted injuries do not fall within the compass of § 523(a)(6).” *Kawaauhau v. Geiger*, 523 U.S. 57, 64, 118 S. Ct. 974 (1998). The Sixth Circuit has held that “[a]n intentional or deliberate act alone does not constitute willful and malicious conduct under § 523(a)(6). *Best*, 109 Fed. Appx. at 3, citing *In re Romano*, 59 Fed. Appx. 709, 2003 WL 731723, at *6-7 (6th Cir. Mar. 3, 2003). “[T]he injury must invade the creditor’s legal rights ... ‘in the technical sense, not simply harm to a person.’” *Id.* at 6 (citing *In re Geiger*, 113 F.3d 848, 852 (8th Cir.1997), *aff’d*, 523 U.S. 57, 118 S. Ct. 974, 140 L. Ed. 2d 90 (1998)).

“Conversion” is “the appropriation of another’s property to one’s own use and benefit, by the exercise of dominion over the property in defiance of the owner’s right to the property.” *Ralston v. Hobbs*, 306 S.W.3d 213, 221 (Tenn. Ct. App. 2009). Collateral estoppel, or issue preclusion, bars the same parties or their privies from relitigating in a second suit issues that were actually raised and determined in the former suit. *Massengill v. Scott*, 738 S.W.2d 629, 631 (Tenn. 1987). The Somerville Complaint, relied upon by the Plaintiff, alleges that:

8. Since about August of 2008, Defendants have fraudulently been converting rents of properties that are subject of Promissory Notes. All Promissory Notes and Deeds of Trust provide for rents to be accessible by the Note Holder. Defendants, upon information and belief and even after repeated demands by Plaintiff not to do so, have contacted rental property tenants to forward rents to them.

Ex. A to Dkt. No. 1. The Somerville Order, however, makes no factual findings beyond establishing that the Defendants are indebted to the Plaintiff in the amount of \$2,059,101.00.² The order makes no reference to willfulness or malice, and a finding of conversion was not necessary to its judgment. Therefore, the issue of willful and malicious injury is not foreclosed by the state court judgment.

The adversary complaint makes no new allegations from which the court may infer willfulness or malice beyond those which it quotes from the Somerville Complaint. Even had the Plaintiff used the word “conversion” in the adversary complaint, this would have been no more than a legal conclusion. In order to survive the motion to dismiss, the complaint must contain facts from which the court may infer a colorable claim. There are none.

III.

The complaint filed by BBC Holding in this adversary proceeding fails to state a claim upon which relief may be granted. The Plaintiff shall have fourteen days to amend its complaint to correct this defect failing which this adversary proceeding will be **DISMISSED WITH PREJUDICE**.

cc: Debtors/Defendants
Attorney for Debtors/Defendants
Plaintiff
Attorney for Plaintiff
Chapter 7 Case Trustee

² As we have seen, I believe that this includes some double counting, and that the amount actually owed to BBC Holding is \$1,931,101.00.