**Dated: April 07, 2020**
**The following is ORDERED:**

Jennie D. Latta
**UNITED STATES BANKRUPTCY JUDGE**

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UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

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In re
SANDRA KAYE WALLS,
Debtor.

Case No. 18-24787-L
Chapter 7

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iXorp, Inc.,
Plaintiff
v.
Sandra Kaye Walls,
Defendant.

Adv. Proc. No. 18-00215

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**ORDER DISCHARGING CLAIM NO. 7**
**AND DISALLOWING CLAIM NO. 12**

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THE COMPLAINT TO DETERMINE the Dischargeability of Debt and Debtor's Objection to Claim Number 12 were tried on January 22, 2020. At the parties' request, post-trial briefs were permitted. Plaintiff iXorp, Inc. ("iXorp") filed its Post-Trial Brief on February 21, 2020. [Adv. Dkt. No. 41]. Defendant, Sandra Kaye Walls ("Walls"), filed her Post Trial

Memorandum on March 20, 2020. [Adv. Dkt. No. 42]. Plaintiff filed a Reply Brief on March 27, 2020. [Dkt. No. 43]. These matters are now ripe for decision.

## FACTS

### Background

Walls is the sole owner and business manager of AVPOL International, LLC, d/b/a AIL Logistics Solutions ("AVPOL"), a Texas corporation with its principal place of business in Memphis, Tennessee. [Adv. Dkt. Nos. 1 and 5].

AVPOL and iXorp entered into a Factoring and Security Agreement on April 22, 2016, whereby AVPOL agreed to sell some of its accounts receivable to iXorp. [Wilson Testimony[1]].

The Factoring and Security Agreement was amended October 15, 2016, to accommodate 60-day invoices. [Wilson Testimony].

AVPOL properly remitted all receipts from factored receivables to iXorp for several months but started falling behind sometime in the fall of 2016. Wilson testified that he became aware of missed payments in December 2016. [Wilson Testimony]. From that time until March 2017, iXorp continued to purchase AVPOL accounts, and AVPOL remitted approximately $372,200 to iXorp. [Wilson Testimony; Walls Testimony; Def. Tr. Ex. 2].

The Factoring and Security Agreement was terminated in April 2017, when AVPOL entered into a new factoring agreement with MBE Capital Partners, LLC ("MBE"). [Wilson Testimony.]

[1] Bob Wilson, Chief Operating Officer of iXorp, LLC, at all relevant times, testified at trial on behalf of Plaintiff.

At that time, AVPOL was indebted to iXorp in the amount of $363,289.10. This is reflected in a Promissory Note given by AVPOL to iXorp dated April 18, 2017. Walls personally guaranteed that obligation.

MBE, AVPOL, and iXorp entered into an Intercreditor Agreement whereby MBE agreed to send 3% of invoices purchased from AVPOL to iXorp to reduce AVPOL's obligation to iXorp. [Tr. Ex. 7]. As a result of this agreement, the obligation of AVPOL to iXorp was reduced to $295,091.46. [Wilson Testimony].

iXorp made no additional direct advances to AVPOL after April 18, 2017. [Walls Testimony].

Unbeknownst to Walls, MBE and iXorp had entered into a Refactoring Agreement whereby iXorp agreed to purchase AVPOL accounts from MBE. [Wilson Testimony; Tr. Ex. 8].

Walls gave notice to Wilson on August 5, 2017, that AVPOL was breaking ties to MBE. [Tr. Ex. 11.].

AVPOL filed a Chapter 7 petition on May 1, 2018. [Wilson Testimony].

**Walls' Bankruptcy Case**

The Defendant commenced her bankruptcy case by filing a voluntary petition under Chapter 7 of the Bankruptcy Code on June 8, 2018. [Bankr. Dkt. No. 1]. Walls scheduled assets in the amount of $202,413.37, and liabilities in the amount of $1,634,962.93. [Bankr. Dkt. No. 1, Summary of Assets and Liabilities]. Among her liabilities, Walls scheduled the guaranty obligation to iXorp in the amount of $363,000.00 [Bankr. Dkt. No. 1, Schedule E/F].

iXorp filed Proof of Claim No. 7 in the amount of $302,872.07, on September 7, 2018. Attached to Claim No. 7 in support of that claim are copies of a Loan Agreement by and among iXorp, AVPOL, and Walls dated April 18, 2017, and a Promissory Note dated April 18, 2017,

whereby AVPOL promised to pay iXorp the principal sum of $363,289.10. There is no attachment setting forth how the amount of the claim was calculated as required by Federal Rule of Bankruptcy Procedure 3001(c)(2)(A). [Claims Register 7-1].

iXorp filed Proof of Claim No. 12 in the amount of $948,032.40, on October 4, 2018. Attached to Claim No. 12 in support of that claim are copies of a Factoring and Security Agreement between AVPOL and iXorp, dated April 22, 2016, and a copy of a Guaranty Agreement executed by Walls as Guarantor on April 21, 2017. There is no attachment setting forth how the amount of the claim was calculated as required by Federal Rule of Bankruptcy Procedure 3001(c)(2)(A). [Claims Register 12-1].

The Defendant objected to Claim No. 12 on October 11, 2018, stating that:

1. The amount of said proof of claim is significantly in excess of the amount sought in the adversary complaint which was $295,091.46; further, the records attached to the claim are inaccurate.
2. The promissory note signed by Debtor, individually, was in the amount of $363,289.10, so claimant's records are inconsistent and unreliable.
3. There is no express contract or privity of contract between iXorp and Debtor, other than the promissory note Debtor signed.
4. The amounts shown in the exhibits attached to the Proof of Claim were all incurred by AVPOL International, LLC and not in the Debtor's individual name and therefore she is not personally liable for the corporate debts.

[Bankr. Dkt. No. 37].

**The Adversary Proceeding**

Plaintiff commenced Adversary Proceeding No. 18-00215 by filing its Complaint to Determine Dischargeability of Debt on September 6, 2018. [Adv. Dkt. No. 1].

The Complaint prays that a non-dischargeable judgment be entered in favor of iXorp against Walls in an amount totaling $295,091.46, as of June 8, 2019, plus pre-judgment interest of 6%, and that iXorp be awarded reasonable attorney's fees, costs and expenses in an amount of $7,780.61, pursuant to the Factoring Agreement and Loan Documents. [Adv. Dkt. No. 1].

The Complaint alleges that the obligation of Walls to iXorp should be excepted from discharge pursuant to sections 523(a)(2)(A) (fraud, false pretenses, false representation or actual fraud), 523(a)(4) (defalcation while acting in a fiduciary capacity), and 523(a)(6) (willful and malicious injury to property) of the Bankruptcy Code.

Attached to the Complaint were copies of the Loan Agreement, Guaranty Agreement, and Promissory Note.

Walls filed an Answer to the Complaint on October 15, 2018. [Adv. Dkt. No. 5]. Walls denies that her obligation to iXorp should be excepted from discharge. Walls affirmatively defends that the acts complained of were performed in a corporate capacity and for the benefit of AVPOL, not by Walls individually. Walls also notes that although the Complaint seeks $295,091.46, iXorp has filed a proof of claim in the amount of $948,032.40, and that other records indicate different amounts allegedly owed.

**The Trial**

The Plaintiff presented the testimony of Bob Wilson, an investor in Plaintiff iXorp, LLC, and at all relevant times, its Chief Operating Officer.

At trial, the following exhibits were admitted: iXorp Proofs of Claim [Tr. Ex. 1]; Factoring and Security Agreement [Tr. Ex. 2]; First Addendum to the Agreement [Tr. Ex. 3]; Promissory Note [Tr. Ex. 4]; Loan Agreement [Tr. Ex. 5]; Guaranty Agreement [Tr. Ex. 6]; Intercreditor Agreement by and among AVPOL, iXorp and MBE [Tr. Ex. 7]; Refactoring Agreement [Tr. Ex. 8]; Bankruptcy Schedules and Statements [Tr. Exs. 9 and 10]; email from Walls to Wilson and Bales [Tr. Ex. 11]; and email from Walls to Wilson and Bales [Tr. Ex. 16].

Walls and a former employee of AVPOL, Bridget Lynn Damper, testified for the Defendant. Walls' tax returns for 2016 and 2017 were admitted as Defendant's Exhibit 1 and a summary of payments made by AVPOL to iXorp was admitted as Defendant's Exhibit 2.

**JURISDICTION**

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). Determination of an objection to discharge or the dischargeability of a particular debt and the allowance or disallowance of claims against the estate are core proceedings arising under the Bankruptcy Code. *See*, 11 U.S.C. § 157(b)(2)(B), (I) and (J). Accordingly, this court has authority to hear and determine this adversary proceeding and the Debtor's Objection to Claim Number 12 subject to appellate review under section 158 of Title 28. 28 U.S.C. § 157(b)(1).

## ANALYSIS

### Standard for Determining Exceptions to Discharge

Exceptions to discharge are to be narrowly construed in favor of the debtor. *Meyers v. I.R.S. (In re Meyers),* 196 F.3d 622, 624 (6th Cir.1999). The party seeking the exception to discharge bears the burden of proof by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 286, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991).

### Proof of Claim No. 7 and the Adversary Complaint

Walls admits that she is obligated to iXorp as the result of her guaranty of the obligation of AVPOL. She admitted that on Bankruptcy Schedule E/F and again at trial. The Complaint states that the remaining balance under the Promissory Note is $295,091.46, plus attorney fees in the amount of $7,780.61. Proof of Claim Number 7, in the amount of $302,872.07, is consistent with the Complaint. No objection was filed with respect to Proof of Claim Number 7, and it is deemed allowed by virtue of 11 U.S.C. § 502(a).

iXorp alleges that the guaranty claim should be excepted from discharge under any of three theories: that it resulted from fraud or misrepresentation; that it resulted from defalcation in a fiduciary capacity; or that it resulted from willful and malicious injury to property. 11 U.S.C. §§ 523(a)(2)(A), (4), and (6). Walls argues that the Loan Agreement, Promissory Note, and Guaranty represent a novation that extinguished prior obligations under the Factoring and Security Agreement.

#### *Novation*

The Factoring and Security Agreement specifies that it is governed by the laws of the state of Tennessee. [Tr. Ex. 2, ¶ 9]. The most recent discussion of novation by the Tennessee Supreme Court is found in *TWB Architects, Inc. v. Braxton, LLC,* 578 S.W.3d 879 (Tenn. 2019). There the

court explains, "Novation is the substitution of a new obligation for an existing one or the substitution of a third party for the existing obligor." *Id., at 890,* citing 30 *Williston on Contracts* § 76.1 (4th ed.) (May 2019 Update), and 58 Am. Jur. 2d *Novation* § 1 (May 2019 Update). The Tennessee court further explains that the "effect of a novation is that the original contract becomes a nullity, and the new agreement determines the rights and duties of the parties." *Id.,* at 890. "The party seeking to establish a novation," the court says, "must show '(1) a previously valid obligation, (2) the agreement of all parties to a new contract, (3) the extinguishment of the old contract, and (4) a valid new contract.'" *Id.,* at 891, citing 21 Steven W. Feldman, *Tennessee Practice Series Contract Law and Practice* § 3:42 (May 2019 Update). The most important factor is the intent of the parties, which must be "clear and definite." *Id.* The party asserting novation bears the burden of proof, but express words such as "novation," discharge," "extinguish," "settlement," or "release" are not required. *Id.*

No one questions the validity of the Factoring and Security Agreement, Loan Agreement, Promissory Note, or Guaranty. No one questions the agreement of the parties to a new agreement expressed in the Loan Agreement, Promissory Note, and Guaranty. Thus, elements 1, 2, and 4 necessary to show a novation are established. The remaining question is whether the parties intended a novation. iXorp asserts that they did not, while Walls asserts that they did.

The intent of the parties may be discovered through their written agreements and their actions. The Loan Agreement expressly references the default of AVPOL on its obligations to iXorp, and refers to the Factoring and Security Agreement as the parties' "Prior Agreement." [Tr. Ex. 5, Recitals B and D]. The Loan Agreement grants iXorp a security interest in all personal property of AVPOL and the membership interest of Walls in AVPOL, which it did not have under the Factoring and Security Agreement. The Loan Agreement also requires the guaranty of Walls,

which iXorp did not have under the Factoring and Security Agreement. [Tr. Ex. 5, § 2.C; Tr. Ex. 2, § 6.1]. The Loan Agreement is made "to facilitate a resolution of [AVPOL's] outstanding obligation to iXorp" by entering into "that certain Factoring ad Security Agreement … with MBE …, in exchange for iXorp's agreement to subordinate its lien on [AVPOL's] accounts receivable to MBE." [Tr. Ex. 5, Recital C]. iXorp agreed to subordinate its rights to collateral arising from the Loan Agreement to the security interest of MBE in the Intercreditor Agreement. [Tr. Ex. 7, § 2.]. Even though Wilson was aware of AVPOL's default in December 2016, iXorp continued to purchase accounts from AVPOL through February 2017. [Wilson Testimony; Walls Testimony]. No accounts were sold by AVPOL to iXorp pursuant to the Factoring and Security Agreement after February 28, 2017. [Tr. Ex. 17]. Instead, AVPOL sold its accounts to MBE pursuant to its new factoring agreement until August 2017, when Walls gave notice to Wilson and Bales that there was a "split in the relationship between AIL [i.e., AVPOL] and MBE." [Tr. Ex. 11]. In her email, Walls specifically refers to trying to obtain an accounting of the 3% that was to be withheld by MBE to pay iXorp.

All of these facts point to the intention of the parties to terminate the Factoring and Security Agreement. From these facts the court finds that the parties intended to and did terminate the Factoring and Security Agreement between AVPOL and iXorp when they entered into the Loan and Security Agreement. AVPOL sold no additional accounts to iXorp pursuant to that agreement, and iXorp was paid pursuant to the Promissory Note and Intercreditor Agreement rather than pursuant to the Factoring and Security Agreement. The agreement expressed in the Loan Agreement, Promissory Note, Guaranty, and Intercreditor Agreement was substituted for the existing obligations of AVPOL under the Factoring and Security Agreement.

Each of the elements necessary to establish a novation has been shown. The Promissory Note was thus the only remaining obligation of AVPOL to iXorp when Walls' bankruptcy petition was filed. In the language of the Tennessee Supreme Court, the original obligation, i.e., the Factoring and Security Agreement, is a nullity. None of the acts of Walls prior to the new agreements can give rise to liability for her under the Factoring and Security Agreement, and all obligations under the Factoring and Security Agreement were subsumed in the Promissory Note and Guaranty. There can be no additional liability arising out of the Factoring and Security Agreement, and iXorp admitted that the liability under the Guaranty is limited to $302,872.07 when it filed Proof of Claim Number 7.

***Amounts Due from MBE***

The Complaint does allege, however, that Walls redirected payments owed to MBE, including the portion that should have been paid over to iXorp, to AVPOL and/or herself. Although it could have made its theory more clear, it seems to assert that had Walls not acted improperly with respect to AVPOL's agreement with MBE, the debt under the Promissory Note, and thus under the Guaranty Agreement, would have been further reduced.

iXorp's theory must fail for a number of reasons. First, the factoring agreement between MBE and AVPOL is not part of the record before the court. The court does not know the terms of that agreement and cannot determine whether there was a breach of that agreement by AVPOL or not. Walls indicated in her email to Wilson and Bales that she believed that MBE had breached its agreement with AVPOL. [Tr. Ex. 14]. Second, the Intercreditor Agreement makes **MBE, not AVPOL,** responsible for paying iXorp 3% of accounts sold to MBE by AVPOL:

> Out of funds otherwise due and payable by Senior Creditor [MBE] to Debtor [AVPOL] under the Factoring Agreement, Senior Creditor shall pay 3% of all invoices presented by Debtor for funding to Subordinating Creditor [iXorp] for the

> account of the Debtor to settle certain indebtedness of the Debtor to the Subordinating Creditor.

[Tr. Ex. 7, § 4.3]. This section directs MBE to pay iXorp at the time of **funding**, not at the time of collection. Nothing that AVPOL did or did not do with respect to remitting collected receivables to MBE could have reduced the amount paid to iXorp under the Intercreditor Agreement. Third, iXorp offered no proof of the amount that it alleges was improperly withheld by AVPOL from MBE or of the amount improperly withheld by MBE from iXorp. Fourth, even if MBE failed to fully perform its obligation under the Intercreditor Agreement, and even if that resulted from some action or inaction of AVPOL and/or Walls, it would not have increased the obligation of AVPOL to iXorp, but would merely have failed to reduce it. Significantly, it was AVPOL who terminated the agreement with MBE. Nothing in the record suggests that iXorp was unhappy with the arrangement prior to its termination by AVPOL on August 5, 2017.

**Proof of Claim Number 12**

iXorp filed a second claim in addition to its claim arising out of the Promissory Note and Guaranty. Proof of Claim Number 12 asserts that iXorp is owed $948,032.40. Attached to the proof of claim are copies of a Factoring and Security Agreement between AVPOL and iXorp, and the Guaranty Agreement. No explanation of how the amount of the claim was derived is attached as required by Federal Rule of Bankruptcy Procedure 3001(c). This claim was not the subject of the Complaint. Walls objected to the claim; thus, it does not enjoy any presumption of validity. *See* 11 U.S.C. § 502(a); *In re Parrish,* 326 B.R. 708, 719 (Bankr. N.D. Ohio 2005). Without the presumption of validity, the burden falls back on the claimant to prove the claim by a preponderance of the evidence. *In re Brown,* 603 B.R. 786, 791 (Bankr. S.D. S.C. 2019); *In re Kemmer,* 315 B.R. 706, 713 (Bankr. E.D. Tenn. 2004).

When asked about the additional claim at trial, Wilson made some reference to the Refactoring Agreement between MBE and iXorp. [Tr. Ex. 8]. AVPOL was not a party to that agreement. Walls testified that she was not aware of the agreement. Wilson testified that Walls expressed confusion when he asked her about it. iXorp has not demonstrated how the Refactoring Agreement can form the basis of a claim against AVPOL, much less how it might form the basis for a claim against Walls. Moreover, the Refactoring Agreement was not attached to Proof of Claim Number 12. The court is merely speculating that it is the basis of iXorp's additional claim.

Because iXorp has failed to carry its burden of proving its Proof of Claim Number 12, the claim will be disallowed in its entirety.

**Piercing the Corporate Veil**

iXorp argues that it is appropriate to pierce the corporate veil of AVPOL to establish a claim against Walls. Courts may pierce the corporate veil and "attribute the actions of a corporation to its shareholders" when appropriate. *Doghouse Investments, LLC v. Teal Properties, Inc.,* 448 S.W.3d 905, 917 (Tenn. Ct. App. 2014), citing *CAO Holdings, Inc. v. Trost*, 333 S.W.3d 73, 88 (Tenn. 2010). The only claim established by iXorp to be owed by AVPOL, however, is the claim represented by the Promissory Note, which Walls is obligated to pay by virtue of the Guaranty Agreement. She has not objected to Proof of Claim Number 7 which includes the remaining principal amount owed by AVPOL together with attorney fees, and is the same amount demanded in the complaint. There is no reason to consider piercing the corporate veil when the full amount owed by the corporation is guaranteed by the individual Defendant.

**The Exceptions to Discharge**

iXorp alleges that the guaranty claim should be excepted from discharge under any of three theories: that it resulted from fraud or misrepresentation; that it resulted from defalcation in a

fiduciary capacity; or that it resulted from willful and malicious injury to property. 11 U.S.C. §§ 523(a)(2)(A), (4), and (6). All of its allegations in support of its theories, however, are based upon activities of Walls that occurred prior to the execution of the Loan Agreement, Promissory Note, and Guaranty. The court has found that a novation occurred when those documents were signed. Therefore, none of the activities of Walls leading up to the execution of the new agreement may form the basis for excepting the claim based on those agreements from discharge.

Wilson testified that he was aware that AVPOL was in default as early as December 2016. Nevertheless, iXorp continued to purchase accounts from AVPOL for three months. AVPOL sold no additional accounts to iXorp after it entered into the new factoring agreement with MBE. iXorp has not pointed to any funds collected by AVPOL after the novation that were not properly remitted. iXorp has failed to carry its burden of proving that any of the exceptions to discharge apply to the Guaranty Agreement.

**CONCLUSION**

For the foregoing reasons, the **IT IS ORDERED** that:

1. Judgment on the Complaint shall be entered in favor of the Defendant, Sandra Kaye Walls, and against the Plaintiff, iXorp, Inc. The obligation represented by Proof of Claim Number 7 is **DISCHARGED**.
2. Proof of Claim Number 12 is **DISALLOWED**.

cc: Debtor/Defendant
Attorney for Debtor/Defendant
Plaintiff
Attorneys for Plaintiff
Chapter 7 Trustee
United States Trustee