



Dated: August 18, 2021
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
CORNELIUS RAY SANDERS,
Debtor.

Case No. 21-20065-L
Chapter 13

VERONICA DENISE SANDERS,
Debtor.

Case No. 21-22279-L
Chapter 13

(Jointly Administered)

DAN H. SHELL, III, M.D., PLLC,
Plaintiff,

v.

Adv. Proc. No. 21-00046

CORNELIUS RAY SANDERS and
VERONICA DENISE SANDERS,
Defendants.

ORDER GRANTING MOTION TO DISMISS

BEFORE THE COURT is the *Motion to Dismiss Pursuant to Fed. R. Bankr. P. 7012(b)(6)* filed by the Defendants Cornelius Ray Sanders and Veronica Denise Sanders (collectively “Sanders” or “Debtors”) on May 26, 2021. ECF No. 7. The Motion asks that the court dismiss the

Complaint Objecting to Dischargeability of Debt filed by the Plaintiff, Dan H. Shell, III, M.D., PLLC (“Shell”) on April 6, 2021. ECF No. 1. A response and reply were timely filed. ECF Nos. 11 and 17. The court heard oral argument on August 12, 2021.

The Complaint asks that the claim of Shell, in the amount of \$409,475.45, be excepted from discharge on one of two theories: (1) under 11 U.S.C. § 523(a)(6) as a debt for willful and malicious injury to another entity or to the property of another entity; and (2) under 11 U.S.C. § 523(a)(4) as a debt for fraud or defalcation while acting in a fiduciary capacity. After further reflection, the Plaintiff concedes that debts that would be excepted from discharge under section 523(a)(6) are generally dischargeable in Chapter 13. *See* 11 U.S.C. § 1328(a). Thus, the court will only consider whether the Complaint states a claim for relief under section 523(a)(4).

BACKGROUND FACTS

Defendant Cornelius Ray Sanders filed a petition for relief under Chapter 13 of the Bankruptcy Code on January 7, 2021. Bankruptcy Case ECF No. 1. Cornelius Ray Sanders filed an Amended/Corrected Petition on January 22, 2021, which attempted to add Defendant Veronica Denise Sanders as a debtor. C. Sanders Bankr. ECF No. 14.

Shell filed its proof of claim on March 10, 2021, in the amount of \$409,475.45, based upon an *Order Granting Motion for Rule 37 Sanctions, Imposing Constructive Trust, and Amending Prior Order* entered in the Chancery Court of Shelby County, Tennessee, in a case styled *Shell v. Spa Therapies, LLC, Veronica Sanders, and Cornelius Sanders, Individually*, Case No. CH-18-0055 (the “Sanctions Order”). Claim No. 16-1. The Sanctions Order recites as follows:

By Motion Made and facts presented to this Court, and it appearing that the Plaintiff’s Motion for Rule 37 Sanctions, and to Amend Prior Order is well taken, and this Court finds that,

1. The Defendants did not comply with the Courts [sic] Order for mediation, and have failed to produce the documents identified in the Prior Consent Order,

2. That the dissolution of Spa Therapies, LLC without the statutorily required distribution of the assets of the LLC, to the Creditors of the LLC has necessitated a \$380,843.21 judgment against Cornelius Sanders and Veronica Sanders, individually under a Constructive Trust imposed by the Court for failing to dissolve Spa Therapies, LLC as required by statute in fraud of creditors.

Wherefore, it is ordered that a Constructive Trust is imposed against Cornelius Sanders and Veronica Sanders, individually, for the judgment amount of \$380,843.21 for monies owed and adjudged against Spa Therapies, LLC, and a sanction of \$2,000.00 is awarded to Plaintiff in attorney's fees against Cornelius and Veronica Sanders individually. For a total judgment against Cornelius and Veronica Sanders of \$382,843.21 individually, with all cost assessed against Defendant's [sic] for which let execution lie.

Claim 16-1, pp. 6-7. Shell's proof of claim includes costs and post-judgment interest for a total claim of \$409,475.45.

Shell commenced this adversary proceeding by filing its Complaint on April 6, 2021. Defendants responded with their Motion to Dismiss on May 26, 2021.

On June 25, 2021, Veronica Denise Sanders voluntarily dismissed herself from the joint case. Bankruptcy ECF No. 68. On July 13, 2021, Veronica Denise Sanders filed a new voluntary petition under Chapter 13, which was assigned case number 21-22279. At the request of the Defendants, the case of Veronica Denise Sanders is being jointly administered with the case of Cornelius Ray Sanders.

Cornelius Ray Sanders proposes to pay \$7,000 every month for 60 months to fund his plan. His plan treats the claim of Shell as a general unsecured claim. C. Sanders Bankr. ECF No. 17. Veronica Denise Sanders proposes to pay \$3,500 every two weeks for 60 months to fund her plan. Her plan also treats the claim of Shell as a general unsecured claim. V. Sanders Bankr. ECF No. 2. Neither of the plans has been confirmed.

The Complaint arises out of a Medical Director Agreement by and between Shell and Spa Therapies, LLC, dated January 17, 2011. Shell sued Spa Therapies, LLC, alleging breach of the

Medical Director Agreement and was awarded a judgment on June 3, 2019. After entry of the judgment, the Defendants dissolved Spa Therapies, LLC, without following the statutorily required distribution of assets. This and the failure of the Defendants to comply with the Chancery Court's order for mediation resulted in the entry of the Sanctions Order.

Count II of the Complaint alleges that the Shell claim should be excepted from discharge pursuant to section 523(a)(4). The Complaint alleges that the Defendants acted as fiduciaries for Shell pursuant to the "original agreement" (the Court assumes this to be the Medical Director Agreement) and the judgment against Spa Therapies, LLC. The Complaint alleges that the Defendants breached their fiduciary duty to Shell when they did the following:

- a) Debtors as the co-owners of Spa Therapies, LLC used the assets of Spa Therapies, LLC in their new business, Ivy Spa; b) the Debtors continued doing business in the same location; c) the Debtors used the same phone number for the new business; and d) the ownership of the new business did not change in any meaningful way; and Debtors attempted to hinder, delay, and defraud Shell from collecting on the obligations owed him.

Complaint, ECF No. 1, ¶ 24. The Complaint further alleges that "[a]s a direct and proximate result of the foregoing, Shell has suffered damages that are now equal to the Judgment, which should be excepted from discharge." The Complaint further alleges that "[b]ased upon the foregoing fraud and defalcation, Plaintiff requests that the debt owed to Plaintiff by Debtors be deemed non-dischargeable in their bankruptcy." Complaint, ECF No. 1, ¶ 25.

ANALYSIS

The Sanders ask that the Complaint be dismissed pursuant to Federal Rule of Bankruptcy Procedure 7012(b) that incorporates Federal Rule of Civil Procedure 12(b)(6), which permits a party to assert failure to state a claim upon which relief can be granted as a defense by motion before a responsive pleading is filed. Specifically, the Sanders assert that the law is clear that a claim of fraud or defalcation while acting in a fiduciary capacity must be based upon the presence

of an express or technical trust rather than a constructive trust. The Sanders are correct. Count II of the Complaint is based upon fraud and defalcation while acting in a fiduciary capacity. To state a claim under section 523(a)(4), both fraud and defalcation are dependent upon the presence of a pre-existing fiduciary relationship between the debtor and creditor. Whether or not a fiduciary relationship exists is determined under federal, not state law. *Commonwealth Land Title Co. v. Blaszak (In re Blaszak)*, 397 F.3d 386, 390-91 (6th Cir. 2005); *see also Carlisle Cashway, Inc. v. Johnson (In re Johnson)*, 691 F.2d 249, 251 (6th Cir. 1982). The fiduciary relationship must arise out of a pre-existing express or technical trust: “It is well established that the defalcation provision of § 523(a)(4) applies to express or technical trusts, but not to constructive trusts that courts may impose as an equitable remedy.” *Blaszak*, 397 F.3d at 391.

The Complaint relies upon the Medical Director Agreement and the Chancery Court Order to establish the necessary fiduciary relationship. The Medical Director Agreement was not provided to the court, but the Complaint specifically describes it as an agreement between Shell and Spa Therapies, LLC. As described, it cannot be the basis for a fiduciary relationship between the Shell and the Defendants. The Chancery Court Order imposes a constructive trust against the Defendants individually for the judgment rendered against Spa Therapies, LLC. The constructive trust imposed by the Chancery Court is an equitable remedy imposed because the Defendants used the assets of Spa Therapies, LLC, in their new business, Ivy Spa. The debt owed to Shell by the Defendants arose as the result of the Chancery Court Order. The Complaint does not suggest that there was a pre-existing fiduciary relationship between them, as is required to establish a claim under section 523(a)(4). *See Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333, 55 S. Ct. 151, 79 L. Ed. 393 (1934), quoted in *Blaszak*, 397 F.3d at 391 (“[t]he language would seem to apply only to a debt created by a person who was already a fiduciary when the debt was created.”)

Realizing the shortcomings in its allegations and relying upon *Sanford v. Waugh & Co., Inc.*, 328 S.W.3d 836, 844 (Tenn. 2010), Shell argues that the Defendants owed it a fiduciary duty when Spa Therapies, LLC became insolvent. The Complaint, however, does not allege that Spa Therapies, LLC *did* become insolvent, and if it did, *when* it became insolvent. Moreover, the Tennessee case does not support Shell's claim against the Defendants. The Tennessee Supreme Court specifically held that individual creditors do not have a direct cause of action for breach of fiduciary duty against directors in the event of insolvency but must instead rely upon a derivative action brought on behalf of the corporation and/or the common law "trust fund doctrine." *Id.* at 847. The trust fund doctrine states that creditors of an insolvent or dissolved corporation are entitled to be paid before assets are distributed to equity holders and that creditors have "a right to follow its assets or property into the hands of anyone who is not a holder in good faith in the ordinary course of business." *Kradel v. Piper Indus., Inc.*, 60 S.W.3d 744, 756 (Tenn. 2001). This doctrine might permit Shell to attach the former assets of Spa Therapies, LLC in the hands of Ivy Spa (or the Defendants but for the filing of their bankruptcy petitions), but that is not the relief sought by Shell in this adversary proceeding. And, although the doctrine uses the language of trust, "[it] is an analogy and is not, and should not be, interpreted literally." 7 *Collier on Bankruptcy* ¶ 1108.10 (16th ed. 2012), quoted in *Hulsing Hotels Tennessee, Inc. v. Steffner (In re Steffner)*, 479 B.R. 746, 765 (Bankr. E.D. Tenn. 2012). The trust fund doctrine does not create an express or technical trust for purposes of section 523(a)(4). *Id.*

According to the allegations of the Complaint, the debt owed to Shell by the Defendants arose from the Chancery Court Order, not from any prior relationship between them. Therefore, the Complaint fails to state a claim under section 523(a)(4). Because the Plaintiff has conceded

that Count I fails to state a claim, the Motion is GRANTED and this adversary proceeding is DISMISSED without prejudice to Shell amending its Complaint, if it can, to state a claim for relief.

cc: Debtors/Defendants
Attorneys for Debtors/Defendants
Plaintiff
Attorney for Plaintiff
Standing Chapter 13 Trustee