

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re:

No. 99-10120
Chapter 7

BRUCE EUGENE DAHRLING, II

Debtor

JOHN DISTERDICK

Plaintiff

v.

Adversary Proceeding
No. 99-1282

BRUCE EUGENE DAHRLING, II

Defendant

MEMORANDUM

Appearances: Everett L. Hixson, Jr., Shumacker & Thompson, P.C.,
Chattanooga, Tennessee, Attorney for Plaintiff

Thomas E. Ray, Wooden, Ray, Fulton & Scarborough,
Chattanooga, Tennessee, Attorney for Defendant

HONORABLE R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

The defendant, Dr. Dahrling, is the debtor in a Chapter 7 bankruptcy case,
and for convenience, the court will refer to him as the Debtor. The plaintiff, Mr. Disterdick,

is one of his creditors. Mr. Disterdick's complaint alleges that the Debtor owes him a debt that can not be discharged in the Debtor's bankruptcy case. The complaint relies on § 523(a)(2)(A) of the Bankruptcy Code. This exception from discharge applies to a debt for money, property, services, or credit obtained by the debtor by means of a false representation, false pretenses, or actual fraud. 11 U.S.C. § 523(a)(2)(A).

This memorandum deals with two motions to dismiss filed by the Debtor. The first motion asserts that the complaint fails to state a claim upon which relief can be granted. *Fed. R. Bankr. P.* 7012; *Fed. R. Civ. P.* 12(b)(6). The second motion asserts that any claim based on fraud must be dismissed because the complaint fails to meet the requirement of Rule 9(b) that the circumstances of fraud must be "stated with particularity." *Fed. R. Bankr. P.* 7009; *Fed. R. Civ. P.* 9(b).

A motion to dismiss under Rule 12(b)(6) tests the sufficiency of the complaint. The question is whether the complaint includes the allegations needed to make out a claim under § 523(a)(2)(A). The court must view the complaint in the light most favorable to the plaintiff. *Smith v. Computer Credit, Inc.*, 167 F.3d 1052 (6th Cir. 1999).

The complaint makes the following allegations.

4. On February 5, 1998, Debtor and Disterdick executed a Promissory Note and Security Agreement with Pioneer Bank on behalf of Darhling P.C. in the principal amount of . . . (\$807,109.29) (hereinafter the "Note"). A copy of the Note is attached hereto as Exhibit "A".

5. The Note was obtained by false pretenses, false representations, or the actual fraud of the Debtor. Debtor knew the representations were false at the time made or were

made by the Debtor with gross recklessness as to its truth. Further, Debtor made the misrepresentations with the intent to deceive Disterdick into executing the Note with Pioneer Bank and Disterdick justifiably relied upon the misrepresentations made by Debtor.

6. Specifically, Disterdick's reliance on the misrepresentations made by Debtor were the proximate cause of his losses. Debtor's actions on behalf of himself and his corporation in intentionally misleading Disterdick constitutes fraudulent conduct by Debtor in that Debtor made specific fraudulent misstatements regarding the purpose of the loan and the nature of the relationship between the parties, and otherwise obtained sums and loans from Disterdick through false and misleading pretenses.

7. Debtor misled Disterdick by causing Disterdick to believe he was executing the Promissory Note with Pioneer Bank on behalf of Debtor's corporation. The purpose of Disterdick executing the Note to Pioneer Bank was to further capitalize the corporation under the Debtor's full and exclusive control and in part, for the purchase of medical equipment by Debtor's corporation which would, in turn, enhance that corporation's ability to generate revenue.

8. Debtor has failed to re-pay or otherwise reimburse Disterdick or Pioneer Bank for the loan extended in exchange for the Note. Accordingly, Disterdick has been damaged as a result of Debtor's misrepresentation and fraud.

Paragraphs 5 and 6 essentially recite the legal requirements for proving a case under § 523(a)(2) without alleging specific facts to support the allegations. The factual allegations are in paragraphs 4, 7, and 8, though the last part of paragraph 6 can be used as an introduction to paragraphs 7 and 8. Combining these paragraphs produces the following factual allegations:

On February 5, 1998, Debtor and Disterdick executed a Promissory Note and Security Agreement with Pioneer Bank

on behalf of Darhling P.C. in the principal amount of \$807,109.29. Debtor made specific fraudulent misstatements regarding the purpose of the loan and the nature of the relationship between the parties. Debtor misled Disterdick by causing Disterdick to believe he was executing the Promissory Note with Pioneer Bank on behalf of Debtor's corporation. The purpose of Disterdick executing the Note to Pioneer Bank was to further capitalize the corporation under the Debtor's full and exclusive control and in part, for the purchase of medical equipment by Debtor's corporation which would, in turn, enhance that corporation's ability to generate revenue. Debtor has failed to re-pay or otherwise reimburse Disterdick or Pioneer Bank for the loan extended in exchange for the Note. Accordingly, Disterdick has been damaged as a result of Debtor's misrepresentation and fraud.

The complaint does not explicitly allege that the Debtor made representations to Mr. Disterdick as to how the money would be used, that the Debtor did not intend to use the money as represented, and that the Debtor did not use it as represented. However, the complaint alleges that the Debtor "misled" Mr. Disterdick into believing he was executing the note "on behalf of" the corporation. The use of "on behalf of" causes a major problem. Theoretically, a note could be executed on behalf of a corporation even if another corporation or an individual was supposed to receive the money. The Debtor's brief makes this point. It contends that the note may have been executed on behalf of a different corporation, Eyecare Centers of the Southeast, which guaranteed the note.

On the other hand, the complaint may use "on behalf of" to mean "for the benefit of." If it means "for the benefit of," then the allegation that the Debtor "misled" Mr. Disterdick into believing he was executing the note on behalf of the corporation is the same as alleging that (1) the Debtor represented the money would be used for the benefit of the corporation, (2) but the Debtor did not intend to use the money for that purpose, and (3)

the Debtor did not in fact use the money for that purpose. The court thinks the complaint means this. This amounts to alleging that the Debtor made a material misrepresentation as to the use of the money, that he knew the misrepresentation was false, and that he intended to deceive Mr. Disterdick.

In addition to these allegations, a complaint under § 523(a)(2) should allege that the plaintiff justifiably relied on the Debtor's misrepresentation, and that his reliance was the proximate cause of his loss.

Paragraph 5 of the complaint includes only a statement of the legal conclusion that Mr. Disterdick justifiably relied on the Debtor's statements. Other parts of the complaint also relate to reliance. As interpreted by the court, the complaint alleges that the Debtor obtained sums and loans from Mr. Disterdick by misrepresenting how the money would be used. Along the same line, the complaint alleges the money was not used as intended by Mr. Disterdick. These allegations taken together amount to an allegation that Mr. Disterdick relied on the alleged misrepresentations when he executed the note. The complaint does not explicitly allege that Mr. Disterdick would not have signed the note except for the Debtor's representations (the usual allegation of reliance), but that seems to be the obvious intent of the allegations taken as a whole.

If there is anything missing, it is an allegation of facts to show that reliance was justified. Plaintiffs sometimes allege prior experience with the debtor to show justifiable reliance. In the absence of prior experience, the plaintiff is often left with little more than a justifiable belief in the debtor's representations – justifiable primarily in the

sense that the debtor's plan for the use of the money appears to be feasible. The complaint contains some allegations along this line. Paragraph 7 alleges that Mr. Disterdick executed the note to obtain capital for the Debtor's corporation, capital that would be used partly to buy medical equipment to enhance the corporation's income. The allegations of the complaint as to the justifiability of Mr. Disterdick's reliance are sufficient to prevent dismissal under Rule 12(b)(6) for failure to state a claim. The lack of specific allegations may be a problem under the particularity requirement of Rule 9(b), but that is a different problem.

The complaint contains a statement of the legal conclusion that the Debtor's alleged misrepresentations were the proximate cause of losses to Mr. Disterdick. The complaint alleges that the Debtor has failed to repay either Pioneer Bank or Mr. Disterdick, and Mr. Disterdick has suffered loss as a result. The complaint could be more specific. It could allege that the note to Pioneer Bank was evidence of a loan to the Debtor or his corporation, that the Debtor or his corporation were supposed to repay the debt, that the Debtor made this representation to Mr. Disterdick, that neither the Debtor nor his corporation has repaid the debt, and that Mr. Disterdick has been forced to repay the debt, which he would not have owed if the Debtor had not misled him in to executing the note. Nevertheless, these are fair inferences from the allegations of the complaint. The court thinks it sufficiently alleges proximate cause to avoid dismissal for failure to state a claim under § 523(a)(2)(A).

Thus, the court will deny the motion to dismiss under Rule 12(b)(6) because the complaint is sufficient to state a claim under § 523(a)(2)(A). *Rembert v. AT & T Universal Card Services, Inc. (In re Rembert)*, 141 F.3d 277 (6th Cir. 1998).

Even if the complaint can not be interpreted to state a claim under § 523(a)(2)(A), the proper course is to allow the plaintiff an opportunity to amend unless an amendment would be futile, and that has not been shown in this proceeding. *Lilley v. Charren*, 936 F.Supp. 708 (N. D.Cal. 1996); *see also Sinay v. Lamson & Session Co.*, 948 F.2d 1037 (6th Cir. 1991).

This brings the court to the Debtor's motion to dismiss under Rule 9(b) for failure to plead fraud with particularity. The court's discussion up to this point reveals some problems with the lack of particularity in the complaint. The complaint also does not state when the Debtor made the alleged misrepresentations, though the court can infer that some were contemporaneous with execution of the note. The complaint fails to allege how and when the money was used for other purposes. Of course, Mr. Disterdick may not have had this information because it may be within the Debtor's control. The allegations as to proximate cause and damages are also rather indefinite.

Nevertheless, when the court is faced with a motion to dismiss under Rule 9(b), the primary question is whether the plaintiff should be allowed an opportunity to amend the complaint to cure its deficiencies. Generally, the court should allow an amendment unless it is convinced the plaintiff can not or will not correct the defect. *Advocacy Organization for Patients and Providers v. Auto Club Insurance Association*, 176

F.3d 315, 331 (6th Cir. 1999); 5 Charles A. Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1300 at 673-74. Nothing in the complaint and no evidence presented to the court suggests that Mr. Disterdick can not or will not amend the complaint to plead the facts with particularity as required by Rule 9(b). Indeed, Mr. Disterdick's response to the Debtor's motions to dismiss clears up some of the confusion or lack of particularity. The response also requests leave to amend the complaint. Therefore, the court will allow Mr. Disterdick time to amend the complaint in order to avoid dismissal for failure to plead fraud with particularity. If Mr. Disterdick files an amendment, and the Debtor thinks the amended complaint still fails to satisfy Rule 9(b), the Debtor can raise the question again.

The court notes that this opinion does not deal with whether any amendment to the complaint will relate back to the filing of the original complaint.

This memorandum constitutes findings of fact and conclusions of law as required by *Fed. R. Bankr. P. 7052*.

ENTER:

BY THE COURT

entered Mar. 10, 2000

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
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ORDER

In accordance with the court's memorandum opinion entered this date,

It is ORDERED that the motion by the defendant to dismiss for failure to state a claim is DENIED; and

It is FURTHER ORDERED that the plaintiff is allowed twenty (20) days after the date of this order within which to file an amendment to the complaint; and

It is FURTHER ORDERED that if the plaintiff files an amendment within the time allowed, the defendant's motion to dismiss for failure to plead fraud with particularity is hereby denied without a further order of the court, but if the plaintiff fails to file an amendment within the

time allowed, the court will enter an order granting the motion to dismiss for failure to plead fraud with particularity.

ENTER:

BY THE COURT

entered Mar. 10, 2000

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE