

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re:

No. 99-10120
Chapter 7

BRUCE EUGENE DAHRLING, II

Debtor

TOLUCA PARK SQUARE TRUST

Plaintiff

v.

Adversary Proceeding
No. 99-1283

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, Toluca Park Square Trust, is a creditor of the Debtor. Toluca Park's complaint alleges that the Debtor owes it a debt that can not be discharged in the Debtor's bankruptcy case. The Debtor has filed a motion to dismiss the complaint for failure to state a claim upon which relief can be granted. *Fed. R. Bankr. P. 7012; Fed. R. Civ. P. 12(b)(6)*. The Debtor has also filed a motion to dismiss all claims based on fraud; the Debtor contends the complaint does not allege the circumstances of the fraud "with particularity" as required by Rule 9(b). *Fed. R. Bankr. P. 7009; Fed. R. Civ. P. 9(b)*. This memorandum deals with those two motions.

Toluca Park's complaint alleges that the debt should be excepted from discharge under Bankruptcy Code § 523(a)(2)(A), which provides:

(a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt —

. . . .

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by —

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

. . . .

11 U.S.C. § 523(a)(2)(A).

Toluca Park's complaint attempts to allege that the Debtor obtained loans from Toluca Park by means of false representations as to how the money would be used. The

elements generally required to prove a false representation case under § 523(a)(2)(A) are set out in *Rembert v. AT & T Universal Card Services, Inc. (In re Rembert)*, 141 F.3d 277 (6th Cir. 1998). The creditor must prove: (1) the debtor made a misrepresentation; (2) when the debtor made the misrepresentation, he knew that it was false or he was grossly reckless as to its truth; (3) the debtor intended to deceive the creditor; (4) the misrepresentation was material to the creditor's decision; (5) the creditor justifiably relied on the misrepresentation; and (6) the creditor's reliance was the proximate cause of its loss. *Rembert*, 141 F.3d 277, 280-81. (The Sixth Circuit stated 1, 2 and 4 as one element.)

The complaint makes the following allegations:

4. Toluca Park is a trust created and existing under the laws of the State of California.

5. On May 1, 1995, Dahrling contemporaneously executed two (2) promissory notes to Toluca Park. This first note is in the principal amount of . . . \$140,000 The second note is in the principal amount of . . . \$100,000

6. The First and Second Notes were 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 Toluca Park into loaning the monies under the Notes, and Toluca Park justifiably relied upon the misrepresentations made by Debtor.

7. Specifically, Toluca Park's reliance on the misrepresentations made by Debtor were the proximate cause of its losses. Debtor misled Toluca Park by causing Toluca Park to believe it was making the loans to Debtor's corporation and not to Debtor. The purpose of Toluca Park's loans to the corporation under Debtor's full and exclusive control was for the purchase of medical equipment by Debtor's corporation, which would enhance that corporation's ability to generate revenue. Debtor's actions on behalf of himself and his corporation in intentionally misleading

Toluca Park 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 Toluca Park through false and misleading pretenses.

8. Toluca Park has not been reimbursed or otherwise repaid either the First Note or the Second Note. Accordingly, the Notes are in default as a result of Debtor's failure to make payments as scheduled.

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 could have explicitly alleged that (1) the Debtor represented to Toluca Park that the money would be used to buy medical equipment for a corporation controlled by the Debtor, (2) when he made the representations, the Debtor did not intend to use the money for that purpose, and (3) the Debtor did not use the money for that purpose. The complaint in effect makes these allegations, but it requires some interpretation. The complaint alleges that the Debtor "misled" Toluca Park into believing it was making the loan to Debtor's corporation and the money would be used to buy equipment for the corporation.

The Debtor contends that Toluca Park could not have been misled into believing the loans were made to a corporation because the Debtor executed the notes personally. In a companion suit filed by Donald Disterdick, the complaint suffered from essentially the same problem. It alleged that Mr. Disterdick executed promissory notes "on behalf of" the Debtor's

corporation. This suggested that Mr. Disterdick was misled as to which entity the notes were executed for. The court, however, interpreted “on behalf of” to mean “for the benefit of” the corporation. Thus, the complaint alleged that Mr. Disterdick was misled into believing the note was being executed to buy equipment for a corporation controlled by the Debtor. This complaint can be interpreted the same way: Toluca Park was misled into believing it was making the loans “for the benefit of” a corporation controlled by the Debtor so that the corporation could buy equipment for its use.

The complaint also alleges that Toluca Park was misled into believing the money would be used to buy medical equipment for the Debtor’s corporation. “Misled” could be interpreted to include unintentional misleading, but the word usually connotes the intent to mislead. *Webster’s Third New International Dictionary* 1444 (1981); *Ballentine’s Law Dictionary* 807 (3rd ed. 1989)

Using these interpretations of the complaint, it alleges that (1) the Debtor represented the money would be used for the benefit of a corporation he controlled, (2) the Debtor did not intend to use the money for that purpose, (3) the Debtor intended to mislead Toluca Park into making the loan, and (4) the Debtor did not use the money as he represented. In other words, the Debtor made a material misrepresentation as to the use of the money, he knew the misrepresentation was false, and he intended to deceive Toluca Park.

In addition to these allegations, a complaint under § 523(a)(2) should allege that the plaintiff justifiably relied on the Debtor’s misrepresentation. The complaint does not make the typical allegation of reliance — the allegation that Toluca Park would not have made the

loans except for the Debtor's misrepresentations. Paragraph 6 of the complaint merely states the legal conclusion that Toluca Park justifiably relied on the Debtor's statements.

The complaint, however, contains other allegations relevant to justifiable reliance. It alleges that the Debtor obtained the loans by false pretenses, false representations, or actual fraud. The complaint then identifies the alleged false representation as a representation that the loans would be used to buy equipment for the corporation. Taken together, these amount to an allegation that the Debtor obtained the loans by means of a false representation as to how the loans would be used. Of course, if the Debtor obtained the loans by making false representations to Toluca Park, then Toluca Park must have relied on the false representations when it made the loans. Thus, the complaint alleges reliance by Toluca Park.

What seems to be missing are factual allegations to show that Toluca Park's reliance was justified. A creditor may allege prior experience with the debtor to show justifiable reliance. In the absence of prior experience, the creditor may be able to allege only that the debtor's business plans appeared to be feasible. Toluca Park's complaint alleges that the loans were made to capitalize the corporation so that it could buy equipment to increase its ability to generate revenue. These allegations are sufficient to allege justifiable reliance. Toluca Park need not include all the details of the Debtor's business plans as represented to Toluca Park. Rule 8 requires only a short and plain statement of the plaintiff's claim. *Fed. R. Bankr. P. 7008; Fed. R. Civ. P. 8.*

The complaint contains a statement of the legal conclusion that the Debtor's alleged misrepresentations were the proximate cause of Toluca Park's losses. The complaint

alleges that the Debtor has failed to repay the loan debts. The complaint could be more explicit. It could allege that its losses were caused by the alleged misrepresentation because Toluca Park would not have made the loans except for the alleged misrepresentation. Nevertheless, that is a fair inference 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).

The lack of specific allegations is more of a problem under the particularity requirement of Rule 9(b). The court's discussion up to this point reveals some problems with the lack of particularity in the complaint. The complaint is unclear as to what corporation was involved and why the Debtor executed the notes personally. 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 notes. The complaint fails to allege how and when the money was used for other purposes. Of course, Toluca Park may not have much of this information because it may be within the Debtor's control. The allegations as to

proximate cause and damages are also rather indefinite. To plead fraud with particularity, the plaintiff generally must allege the time, place, and contents of the fraudulent representations and what the defendant obtained as a result. 5 Charles A. Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1297 at 590. This complaint lacks some of the particulars that should have been alleged.

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 suggests that Toluca Park can not or will not amend the complaint to plead the circumstances of the alleged fraud with particularity as required by Rule 9(b). Likewise, no evidence was presented to show that Toluca Park can not or will not amend the complaint to plead the circumstances with particularity. Indeed, Toluca Park has filed a 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 Toluca Park the opportunity to amend in order to avoid dismissal of the complaint for failure to plead fraud with particularity as required by Rule 9(b). If Toluca Park files an amendment, and the Debtor thinks the amended complaint still does not comply with Rule 9(b), he 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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Defendant

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