UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	)	CHAPTER 11
	)	
DANIEL J. MILES,	)	CASE NO. **09-92601** - MHM
	)	
Debtor.	)	
	)	
MILLBURN PARTNERS, LLC,	)	
	)	
Plaintiff,	)	
v.	)	**ADVERSARY PROCEEDING NO. 10-6229**
	)	
DANIEL J. MILES,	)	
	)	
Defendant.	)	

ORDER GRANTING DEFENDANT'S MOTION TO DISMISS

Plaintiff filed this complaint seeking a determination that its claims against Debtor are nondischargeable. Defendant filed a motion to dismiss on the grounds that Plaintiff fails to state a claim upon which relief can be granted.[1] For the reasons set forth below, Defendant's motion is granted.

Under Bankruptcy Rule 7012, which incorporates Fed. R. Civ. Proc. 12(b)(6) ("Rule 12 (b)(6)"), before filing an answer, a defendant may seek dismissal of a complaint if the complaint fails to state a claim. Therefore, disposition of a motion to dismiss under Rule 12(b)(6) focuses only upon the allegations in the complaint and

[1] Defendant filed a motion to dismiss, which prompted Plaintiff to file an amended complaint. Defendant then filed a motion to dismiss the amended complaint. As the grounds for dismissal of both the complaint and the amended complaint are the same, both motions, and Plaintiff's responses, will be treated together in this order.

whether those allegations are sufficient to state a claim for relief. As Plaintiff's allegations have been stated and restated, and repeated and paraphrased in Defendant's motions and Plaintiff's responses, the allegations in Plaintiff's complaint will be set forth in summary form.

Defendant is the former principal of Miles Properties, Inc. ("MPI"), which was in the business of rehabilitating residential apartment buildings and converting them into condominiums or apartment rentals in several cities in the Southern United States. Each of the numerous buildings were owned through separate, affiliated limited liability companies set up by MPI ("Affiliates"). An involuntary Chapter 7 bankruptcy case was filed against Defendant in December, 2009.[2] MPI and twelve of its Affiliates filed Chapter 11 bankruptcy petitions in January, 2010.

Two types of transactions are the subject of this adversary proceeding. First, from 2003 through 2007, Plaintiff invested in several of the individual Affiliates ("Affiliate Investments"). The amount Plaintiff invested in the Affiliate Investments totals more than $1 million. Periodic statements regarding the Affiliate Investments were sent to Plaintiff. Additionally, financial statements were available on MPI's website.

The second type of transaction was "mezzanine financing" in the form of two $500,000 loans to provide to MPI Development Group, Inc., another Affiliate of MPI (the "Loans"). The first of the Loans was made in August 2007, and renewed in August 2008 (the "Renewal Note"). The second of the Loans was made in May 2008. The first Loan (August 2007) was apparently guaranteed by Defendant individually, but the Renewal

[2] Defendant converted the involuntary Chapter 7 case to a Chapter 11 case, which was subsequently reconverted and is currently a Chapter 7 case.

Note presented to Plaintiff in 2008, which was represented to Plaintiff as providing the same terms as the prior note, did not contain Defendant's personal guarantee. The note relating to the second of the Loans also did not contain Defendant's personal guarantee.

In April 2008, MPI made only partial payments of the amounts due in connection with the Affiliate Investments. In October 2008, MPI stopped making any payments on the Affiliate Investments. In April 2009, MPI stopped making payments on the Loans. The properties of two of the Affiliates in which Plaintiff had invested were foreclosed in July and September 2009. Plaintiff was not informed about these foreclosures. On July 2, 2009, a meeting of investors occurred in Newark, N.J., attended by Defendant and Franco Rizzolo, an executive vice president of MPI, several investors, including Plaintiff, three forensic accountants, and two or three attorneys for Defendant or MPI (the "Newark Meeting"). At the Newark Meeting, a financial package representing Defendant's and MPI's financial information was presented to the investors in an effort to persuade the investors to forebear from taking any legal action against Defendant or MPI to allow MPI to be restructured and returned to profitability. At the Newark Meeting, Plaintiff was for the first time informed about the zero-balance accounting system, which involved commingling funds of MPI and the Affiliates.

Plaintiff seeks a determination that its losses from the Affiliate Investments and the Loans[3] are nondischargeable pursuant to 11 U.S.C. §523(a)(2), (4), (6) and (19).[4]

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[3] The specific amounts of Plaintiff's losses in connection with the Affiliate Investments and the Loans is not set forth in the complaint.

[4] Complaints under §523(a)(2), (4) and (6) are subject to the bardate of §523(c) and Bankruptcy Rule 4007. No bardate is applicable to §523(a)(19).

Defendant asserts that critical elements of each of those claims are missing from Plaintiff's complaint, as amended, and seeks dismissal under Rule 12(b)(6).

CONCLUSIONS OF LAW

Bankruptcy Rule 7008 applies Rule 8 of the Federal Rules of Civil Procedure to adversary proceedings.

> A pleading which sets forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain . . . a short and plain statement of the claim showing that the pleader is entitled to relief.

Fed. R. Civ. Proc. 8(a)(2). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (*quoting Bell Atlantic Corp. v. Twombly*, 550 U.S. 554, 570 (2007)). A complaint is plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (*citing Bell Atlantic*, 550 U.S. at 556). Plausibility does not require probability, but does require something "more than a sheer possibility that a defendant has acted unlawfully." *Id.* (*citing Bell Atlantic*, 550 U.S. at 556).

Count 1: Fraud - §523(a)(2)(A)

A debt is nondischargeable pursuant to 11 U.S.C. §523(a)(2)(A) to the extent that money, property, services, or an extension, renewal, or refinancing of credit, was obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or insider's financial condition. The complaint must allege (1) the debtor made false representations with the intent to deceive; (2) the creditor justifiably relied upon the debtor's false representations; and (3) the creditor sustained a loss as a result of the misrepresentation. *Schweig v. Hunter,* 780 F. 2d 1577 (11th Cir. 1986); *St. Laurent v.*

Ambrose, 991 F. 2d 672 (11th Cir. 1993); *City Bank & Trust Co. v. Vann*, 1995 WL 582036 (11th Cir. 1995); *Field v. Mans*, 516 U.S. 59 (U.S. 1995).

The initial element under §523(a)(2)(A) is that the debtor obtained money by a false representation . The Affiliate Investments were made from 2003 to mid-2007. Most of the misrepresentations Plaintiff alleges were made by Defendant or at Defendant's direction were made *after* 2007. Plaintiff's complaint contains no allegations that would support a reasonable inference that MPI misrepresented or concealed any information about its financial stability prior to Plaintiff's making any of the Affiliate Investments.

A critical fact was, however, concealed from Plaintiff in connection with the Affiliate Investments: Plaintiff alleges Defendant failed to disclose the use of the zero-balance accounting system, which commingled the funds of the Affiliates. With each Affiliate Investment, Defendant and Plaintiff executed an operating agreement that led Plaintiff to believe that its investment was specific to the particular Affiliate. Such a misrepresentation is material, is a representation upon which Plaintiff could justifiably rely and would support a reasonable inference of an intent to deceive.

A critical fact that Plaintiff fails to allege, however, is how funds that were invested with the Affiliates constitute money, property, services, or an extension, renewal, or refinancing of **credit** obtained by Defendant. Also, although it may be assumed that, as the principal of MPI and the Affiliates, Defendant derived his personal income from those entities, the complaint contains no allegations that would support a conclusion that the corporate formalities were not observed or that any of the Affiliate Investment funds were misappropriated or converted by Defendant. Plaintiff failed to allege any facts to support a reasonable inference that Defendant obtained any money from Plaintiff.

Therefore, Plaintiff's allegations as to the Affiliate Investments under §523(a)(2)(A) fail to state a claim upon which relief can be granted.

As with the Affiliate Investments, Plaintiff makes no allegations to show how Defendant obtained money, property, services, or an extension, renewal, or refinancing of credit as a result of the Loans Plaintiff made to MPI Development Group, Inc. Only with respect to the Renewal Note does Plaintiff allege Defendant gained any benefit. The cover letter from Defendant's attorney that accompanied the Renewal Note stated that the Renewal Note reflected the same terms as the initial transaction, but, Plaintiff alleges, in fact the Renewal Note was executed by Defendant in his representative capacity as president of MPI Development Group, Inc. instead of in his individual capacity, as the prior note had been executed.[5] Plaintiff asserts that the difference relieved Defendant of personal liability on the obligation and asserts that Plaintiff had relied on Defendant's personal guarantee when making the Loan. Because the representation that the Renewal Note contained the same terms as the prior note was false and Plaintiff justifiably relied on that representation, it may be inferred that the representation was made with the intent to deceive and that Defendant gained the benefit of being relieved of personal liability.

Defendant contends, however, that Plaintiff could not have justifiably relied upon the false representation in Defendant's attorney's letter, as the Renewal Note accompanied the letter and was clearly executed by Defendant in his representative capacity. Reliance is not justifiable if the falsity of the representation is patent with even a cursory investigation. *Field v. Mans*, 516 U.S. 59 (U.S. 1995). Defendant was, or

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[5] Although a copy of the Renewal Note was attached to the complaint as an exhibit, no copy of the original note was attached.

should have been, in possession of the original note, so that the difference in execution by Defendant should have been evident. Therefore, Plaintiff's allegations as to the Loans under §523(a)(2)(A) fail to state a claim upon which relief can be granted.

Count 2: False financial statement - §523(a)(2)(B)

Section 523(a)(2)(B) is intended to apply to written statements "respecting the debtor's or an insider's financial condition." The statute explicitly states and Congressional comments confirm that §523(a)(2)(A) and (B) are mutually exclusive. 124 Cong. Rec. H11095-96 (daily ed. September 28, 1978); S17412 (daily ed. October 6, 1978). As noted above, the complaint contains no allegations that would support an inference that any financial statement provided to Plaintiff *before* the relevant transactions were false. Additionally, as noted above, even if false financial statements were provided to Plaintiff before the Affiliate Investments or the Loans, Plaintiff failed to allege any facts to support a conclusion or inference that Defendant obtained any money from Plaintiff's Affiliate Investments or the Loans. Therefore, Plaintiff's allegations under §523(a)(2)(B) fail to state a claim upon which relief can be granted.

Count 3: Fraud or defalcation while acting in a fiduciary capacity - §523(a)(4)

Pursuant to 11 U.S.C. §523(a)(4), a debt based on "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" is nondischargeable. The U.S. Supreme Court has consistently interpreted "fiduciary" as used in §523(a)(4) narrowly, holding that the trust upon which the fiduciary relationship relies must be an express or

technical trust. *Davis v. Aetna Acceptance Co.,* 293 U.S. 328 (1934);[6] *see also Quaif v. Johnson,* 4 F. 3d 950 (11th Cir. 1993). The trust must have existed before and not as a result of the defalcation. *Id.*; *Lewis v. Short,* 818 F.2d 693 (9th Cir. 1987); *Murphy & Robinson Investment Co. v. Cross,* 666 F.2d 873 (5th Cir. Unit B 1982);[7] *Angelle v. Reed,* 610 F.2d 1335 (5th Cir. 1980).[8]

The basis for Plaintiff's assertion that Defendant breached a fiduciary duty is based upon Defendant's status as an officer in MPI and the Affiliates. Plaintiff has alleged no other facts to support a conclusion that an express or technical trust existed. Defendant's status as a corporate officer is alone insufficient to establish a fiduciary duty. *See First National Bank of Commerce v. Dove*, 78 B.R. 630 (Bankr. M.D. Ga. 1986); *Blashke v. Standard,* 123 B.R. 444 (Bankr. N.D. Ga. 1991)(J. Bihary). Plaintiff does not assert any claim of embezzlement or larceny against Defendant. Therefore, Plaintiff's allegations under §523(a)(4) fail to state a claim upon which relief can be granted.

Count 4: Willful and malicious injury - §523(a)(6)

Section 523(a)(6) provides that a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity" is nondischargeable. Pursuant to *Kawaauhau v. Geiger,* 118 S.Ct. 974 (1998), debts arising from recklessly or negligently inflicted injuries do not fall within the willful and malicious injury exception

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[6] The *Davis* case was decided under §17(a)(4) of the Bankruptcy Act, which was transmuted virtually unchanged to §523(a)(4).

[7] Decisions of Unit B of the former Fifth Circuit are binding precedent in the Eleventh Circuit. Section 9, Public Law 96-452 (1980).

[8] *Bonner v. City of Prichard,* 661 F.2d 1206 (11th Cir. 1981), renders decisions of the Fifth Circuit issued prior to September 30, 1981, binding precedent for the Eleventh Circuit.

to discharge. "The word 'willful' in (a)(6) modifies the word 'injury,' indicating that nondischargeability takes a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury." *Id.* at 977. Plaintiff fails to allege any facts that would show Defendant possessed an intent to cause harm or injury to Plaintiff. Therefore, Plaintiff's allegations under §523(a)(6) fail to state a claim upon which relief can be granted.

Count 5: Securities fraud - §523(a)(19)

Section 523(a)(19) provides that a debt is nondischargeable if it is for:

> (i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or
>
> (ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; ***and***
>
> (B) results, before, on, or after the date on which the petition was filed, from--
>
> (i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;
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> (ii) any settlement agreement entered into by the debtor; or
>
> (iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

(Emphasis supplied.) Plaintiff fails to allege that its claim against Defendant results from a judgment or order as required by §523(a)(19)(B). The liability determination of a debt described in §523(a)(19) must occur outside the bankruptcy forum; only then does a court

– bankruptcy or non-bankruptcy – determine dischargeability. *Faris v. Jafari*, 401 B.R. 494 (Bankr. D. Colo. 2009); *Fontenot v. Thiele,* 2010 WL 1026972 (Bankr. E.D. Tenn. 2010); *Speck v. Demers,* 2009 WL 3681675 (Bankr. E.D. Wash. 2009); *Holland v. Zimmerman,* 341 B.R. 77 (Bankr. N.D. Ga. 2006) (J. Bonapfel); *Thompson v. Hornyak,* 2010 WL 2044469 (Bankr. N.D. Ga. 2010) (J. Diehl). Therefore, Plaintiff's allegations under §523(a)(19) fail to state a claim upon which relief can be granted.

Accordingly, it is hereby

ORDERED that Defendant's motion to dismiss the amended complaint is ***granted.***

The Clerk is directed to serve a copy of this order upon Plaintiff's attorney, Defendant's attorney, and the U.S. Trustee.

IT IS SO ORDERED, this the 17th day of March, 2011.

MARGARET H. MURPHY
UNITED STATES BANKRUPTCY JUDGE