

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

IN RE: CASE NO. 06-11033)
)
INDUSTRIAL FINISHING SERVICE, INC.)
)
Debtor)
)
)
MARK A. WARSCO, TRUSTEE)
)
Plaintiff)
)
vs.) PROC. NO. 08-1113
)
)
IFS, INC.)
LYLE NEELEY)
)
Defendants)

DECISION AND ORDER ON MOTION TO DISMISS

Industrial Finishing Service, Inc. filed a petition for relief under Chapter 11 of the United States Bankruptcy Code. The case was subsequently converted to Chapter 7 and the plaintiff in this adversary proceeding is the Chapter 7 trustee. Based upon the allegations in the complaint, the corporate defendant, IFS, is engaged in a business that is similar to the debtor's. The individual defendant is the owner of IFS and the son of the debtor's sole shareholder. The activities of the two corporations were supposedly intermingled. Between 2000 and 2005, the debtor's balance sheet shows annually increasing intercompany receivables due the debtor from IFS, so that by the end of 2005 the debtor was owed over \$800,000. By this adversary proceeding, the trustee seeks to recover that amount from both defendants.

The complaint is in three counts. Count I seeks to recover the amount claimed due from IFS based upon the straight-forward proposition that it owes the debtor money. Counts II and III are

based upon characterizing the intercompany receivables as “conveyances.” Count II seeks to recover them through Indiana’s fraudulent conveyance law, I.C. 32-18-2, et seq., using the trustee’s strong arm powers of § 544. Count III seeks to recover them as fraudulent conveyances under § 548 of the Bankruptcy Code.¹ The matter is before the court on defendants’ motion to dismiss Counts II and III. The motion has been filed pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure and argues that the plaintiff has failed to plead fraud with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure.

When the basis of a plaintiff’s claim against a defendant rests upon some type of fraud, it is not enough to set the claim out in the “short and plain statement” that will usually suffice. Fed. R. Civ. P. 8(a). Fraud must be pleaded with particularity. Fed. R. Civ. P. 9(b). Where, as here, the fraud complained of has a statutory basis, the requirements of Rule 9(b) will be satisfied if the elements of the statutory cause of action are stated with sufficient particularity. In re Chochos, 325 B.R. 780, 783 (Bankr. N.D. Ind. 2005) (citing General Electric Capital Corp. v. Lease Resolution Corp., 128 F.3d at 1079). As a third party outsider, who must act for the benefit of creditors and the estate and is often pleading based on secondhand information, a bankruptcy trustee is generally afforded some liberality in pleading fraud. In re O.P.M. Leasing Services, Inc., 32 B.R. 199, 203 (Bankr. S.D.N.Y. 1983). Nonetheless, trustees are not completely free from the particularity requirements of Rule 9(b). For the complaint to be sufficient, in addition to containing the required jurisdictional allegations, it must identify the basis for plaintiff’s right to bring the action – is the

¹The elements of both state and bankruptcy fraudulent conveyance law are much the same. The primary difference between them lies in the time frame covered by each. Section 548 covers only the two years prior to the petition while Indiana’s law covers a period of four years. I.C. 32-18-2-19.

trustee relying upon its own powers, whether under § 548 or § 544(a), or those which belong to an actual creditor, under § 544(b)? – and describe the transfers being challenged. It must also contain allegations corresponding to the statutory elements that make a transfer “fraudulent” and therefore avoidable. See, In re Chochos, 325 B.R. 780, 783 (Bankr. N.D. Ind. 2005). See also, General Electric Capital Corp. v. Lease Resolution Corp., 128 F.3d at 1079-80. Just what that requires will depend upon whether the plaintiff claims the challenged transfers were actually fraudulent or only constructively so.

Neither Count II nor Count III of the complaint sufficiently identifies the transfers being challenged or when they may have occurred. There is only a general allegation that in each year from 2000 through 2005 the debtor’s balance sheet reflects an ever increasing intercompany receivable from IFS.

Count II is based upon Indiana’s fraudulent transfer law and the powers the trustee has been given by § 544 of the Bankruptcy Code. 11 U.S.C. § 544. Section 544(a) allows the trustee to avoid any transfer that would be avoidable by a hypothetical creditor, coming into existence on the date of the petition, regardless of whether such a creditor exists. Section 544(b), on the other hand, allows the trustee to avoid any transfer that might be avoidable by an actual creditor of the debtor. The distinction between a hypothetical creditor coming into existence as of the date of the petition and an actual creditor of the debtor is important because Indiana law makes a distinction between what types of transfers can be avoided based upon when the debt to the complaining creditor was incurred. Any creditor can seek to avoid a transfer (1) that was made with the actual intent to hinder, delay or defraud creditors or (2) for which the debtor did not receive reasonably equivalent value, if it was engaged in business and left with unreasonably small capital or would incur debts beyond

its ability to pay. See, I.C. 32-18-2-14. Only creditors existing at the time of the transaction complained of can seek to avoid a transfer made for less than reasonably equivalent value, while the debtor was insolvent, or which rendered the debtor insolvent. See, I.C. 32-18-2-15. Thus, in analyzing the sufficiency of the other aspects of Count II we must identify which Indiana statute the trustee's claim is based upon – the one available to any creditor or the one available only to creditors existing at the time of the transfer or both.

Count II seems to have elements of both 14 and 15. To the extent it alleges “the conveyances were executed as part of a scheme to defraud the creditors,” Complaint ¶ 28, or that they “were not for reasonably equivalent value . . . and left the debtor with unreasonably small assets in relation to its business . . .,” Complaint ¶ 26, those allegations echo the elements of I.C. 32-18-2-14 which can be used by any creditor, and therefore by the trustee, under § 544(a), without any further demonstration of the right to so. Had the challenged transfers been sufficiently identified, Count II would state a claim under that portion of Indiana law with the required particularity.² But, Count II also contains elements of I.C. 32-18-2-15, when it alleges “the conveyances . . . were not for reasonably equivalent value [and] were made while the debtor was insolvent” Complaint ¶ 26. That portion of Indiana law may only be used by creditors existing at the time of the challenged transfer and to use it the trustee must proceed under § 544(b). To have the right to bring such an action, however, the trustee should plead and must ultimately prove that such a creditor exists; simply being the trustee is not enough. See, In re Lexington Healthcare Group, Inc., 339 B.R. 570, 575-76 (Bankr. D. Del. 2006); In re G-I Holdings, Inc., 313 B.R. 612, 632-33 (Bankr. D. N.J. 2004).

²Rule 9(b) of the Federal Rules of Civil Procedure requires that the circumstances constituting fraud be stated with particularity, but allows intent to be alleged generally. See, Chill v. General Electric Co., 101 F.3d 263, 267 (2nd Cir. 1996).

This latter issue is really a matter of standing – the basis for plaintiff’s right to bring the action – rather than the particularity requirements of Rule 9(b). Yet, a complaint which fails to reveal that the plaintiff has standing to prosecute a claim may be dismissed. See, Retired Chicago Police Association v. City of Chicago, 76 F.3d 856 (7th Cir. 1996). Standing to bring a claim is not part of “the circumstances constituting fraud” and so does not have to be pleaded with particularity. A general allegation will suffice. So, when the trustee is asserting the powers that can only be used by creditors existing at the time of the transfer, the complaint does not need to allege the specific identity of a particular creditor (that can wait until the trustee is required to prove its case) but it should allege that such a creditor exists. Lexington Healthcare, 339 B.R. at 575-76 (citing cases). The complaint has no allegations, particular or otherwise, concerning the continued existence of creditors existing at the time of the transfers complained of and so, notwithstanding the sufficiency of the allegations concerning the statutory elements of I.C. 32-18-2-15, fails to properly allege the trustee’s right to bring such an action.

Count III is based upon the Bankruptcy Code’s provisions concerning avoidable fraudulent conveyances. 11 U.S.C. § 548. It allows the trustee to avoid transfers made with the actual intent to hinder, delay or defraud, 11 U.S.C. § 548(a)(1)(A), or made for less than reasonably equivalent value, when debtor was or became insolvent, was engaged in business with unreasonably small capital or would incur debts beyond its ability to pay. 11 U.S.C. § 548(a)(1)(B). At paragraphs 33 and 34(a)-(c), the complaint contains allegations concerning these elements and so, but for the failure to adequately identify the transfers being challenged, sufficiently alleges claims under both portions of § 548.

Just because a complaint fails to allege claims for the recovery of fraudulent transfers with

the necessary particularity does not mean that the plaintiff cannot do so. The response to the defendants' motion to dismiss contains a significant amount of additional information that, if included in the original complaint, may have allowed the trustee to satisfy the requirements of Rule 9(b). But, the purpose of a motion to dismiss is to test the sufficiency of the complaint and in ruling on such a motion, the court should generally limit its field of view to the information contained in the pleadings. Fed. R. Civ. P. Rule 12(d); Fed. R. Bankr. P. Rule 7012(d). See also, Albany Bank & Trust Co. v. Exxon Mobil Corp., 310 F.3d 969, 971 (7th Cir. 2002) (when ruling on a motion to dismiss the court cannot consider materials which are outside the pleadings). This is particularly so when the motion is based upon the pleading requirements of Rule 9(b). Precious little would be left of those requirements if a plaintiff could successfully supplement a deficient complaint with allegations it was supposed to contain, but did not, by including that information in its response to a motion to dismiss. Rather than being grounds for denying a motion to dismiss, the plaintiff's ability to come forward with the required information suggests that the motion should be granted, but that plaintiff should also be given an opportunity to file an amended complaint and to correct the original shortcomings.

IT IS THEREFORE ORDERED that Counts II and III of the plaintiff's complaint are dismissed. Plaintiff shall have fourteen (14) days from this date within which time to file any amended complaint and defendants shall respond thereto within fourteen (14) days thereafter.

Dated: November 10, 2008

/s/ Robert E. Grant
Judge, United States Bankruptcy Court