UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

In re, Korey Wayne Smith and Stacy Cooke Smith, Debtor(s).	C/A No. 19-03914-HB Adv. Pro. No. 20-80004-HB Chapter 7
Kenneth Suter and Nicole Suter, Plaintiff(s), v. Korey Wayne Smith and Stacy Cooke Smith d/b/a Montgomery Grace, Defendant(s).	**ORDER GRANTING MOTION TO DISMISS**

THIS MATTER is before the Court on the Motion to Dismiss filed by Defendants Korey Wayne Smith and Stacy Cooke Smith d/b/a Montgomery Grace[1] pursuant to Fed. R. Civ. P. 12(b)(6).[2] Plaintiffs Kenneth Suter and Nicole Suter objected and the Smiths filed a response. The Suters filed a Complaint in this bankruptcy case to establish that the Smiths owe them $523,222.00, plus attorney's fees and interest, and the debt is excepted from their discharge pursuant to 11 U.S.C. § 523(a)(2), (4), and (6). To accomplish this, the Suters assert the Court should pierce the corporate veil of Korey Homes Building Group, LLC and find the Smiths personally liable for a debt established against the LLC. The 140-page pleading

[1] ECF Nos. 7, 15, 18.
[2] Made applicable to this adversary proceeding by Fed. R. Bankr. P. 7012.

consists of the main document (17 pages) and Exhibits A through O attached thereto (collectively the "Complaint").[3]

ALLEGATIONS OF THE COMPLAINT

1. Korey Smith owns a 99% interest and Stacy Smith owns a 1% interest in the LLC.

2. On July 9, 2016, the Suters executed a contract with the LLC for the construction of a custom home in Harford County, Maryland in exchange for $927,375.00 (the "Contract").

3. The Contract provided the home would be built to certain specifications and meet applicable building codes. It also required the LLC to enroll the home in a new home warranty program. The Suters allege Korey Smith and the LLC induced them to sign the Contract based on representations that the LLC would fulfill these obligations.

4. When the Suters moved into the home on September 17, 2017, it was not built in compliance with the terms of the Contract and contained significant construction defects. Additionally, no home warranty was provided.

5. A dispute also arose over a change order submitted by the LLC on September 21, 2017, for $84,791.00 in materials and labor supplied to the home ("Change Order #6").

[3] The Court excluded all matters outside the pleadings, *see* Fed. R. Civ. P. 12(d), and considered only the Complaint, which incorporated Exhibits as follows: (A) the mechanic's lien recorded in Harford County, Maryland; (B) change orders executed by the LLC pursuant to its contract with the Suters; (C) the contract between the Suters and the LLC; (D) Change Order #6; (E) the arbitration award and state court judgment; (F) the complaint against the Smiths filed in the U.S. District Court for the District of Maryland (without exhibits); (G) the Entry of Default entered by the Maryland District Court; (H) a post-judgment discovery order entered by the state court; (I) the Smith's motion for protective order filed in the state court; (J) an affidavit of Lauren Lentz; (K) a "rough transcript" of the Smith's meeting of the creditors; (L) a list of homes constructed by the LLC in 2018; (M) transcript excerpts from Korey Smith's Fed. R. Bankr. P. 2004 examination; (N) email correspondence between Korey Smith and Sarah Leizar and correspondence from Jeffrey M. Kotz to Detective Ryan Hall; and (O) email correspondence from Korey Smith to Ken Smith. (ECF No. 1, filed Jan. 15, 2020)

Change Order #6 does not comply the procedure provided in the Contract and the Suters assert it was "bogus."

6. After the Suters failed to pay the amounts in Change Order #6, on March 12, 2018, the LLC recorded a mechanic's lien in Harford County, Maryland and initiated an action to enforce the lien. The Suters responded, seeking to vacate the mechanic's lien and asserting counterclaims against the LLC for breach of contract and related violations of Maryland's Custom Home Protection Act ("Custom Home Act") and Consumer Protection Act.[4]

7. Pursuant to the terms of the Contract, the matter was referred to arbitration and a judgment was entered in favor of the Suters against the LLC in Harford County, Maryland in the amount of $523,222.00 (the "Judgment"). The award was based on the cost to complete the home in accordance with the terms of the Contract and applicable codes and standards, as well as attorney's fees and costs for defending the mechanic's lien.[5]

8. The Suters then initiated an action in the United States District Court for the District of Maryland seeking to pierce the corporate veil of the LLC and hold the Smiths personally liable for the Judgment ("Federal Complaint").[6] The Smiths failed to respond and

[4] The Complaint did not state specific provisions of the Custom Home and Consumer Protection Acts the LLC violated. The Court notes § 10-507 of the Custom Home Act provides "[i]n addition to any other penalty provided elsewhere in the Annotated Code, any conduct that fails to comply with this subtitle, or any breach of any trust created by this subtitle, is: (1) An unfair or deceptive trade practice within the meaning of Title 13 of the Commercial Law Article . . ." Md. Code Ann., Real Prop. § 10-507(a). Additionally, a violation of Title 10, Subtitle 6 of the Real Property Article, which governs new home warranties, constitutes an unfair trade practice. Md. Code Ann., Commercial Law § 13-301(14)(xvi).

[5] On January 9, 2019, the arbitrator determined the LLC breached the Contract and violated the Custom Home and Consumer Protection Acts by failing to issue a home warranty to the Suters when they moved into their home, resulting in damages of $100,000.00. The arbitrator also ruled that, based on the LLC's breach of the Contract and violations of the Custom Home Act and Consumer Protection Act, it was required pay the Suters $371,7500.00 for the cost to build, repair, or replace components of the home that were not delivered or constructed as required by the Contract. The arbitrator also awarded the Suters $31,025.07 in attorney's fees and costs for the LLC's breach of Contract and violations of the Custom Home Act and Consumer Protection Acts, $10,807.51 in attorney's fees for the its breach of the Contract's mandatory arbitration clause, and $9,639.42 for the costs and fees of the arbitration proceeding.

[6] *See* Ex. F. Pages 8, 9 and 10 of the Federal Complaint are missing from Exhibit F; however, they are included elsewhere in the record. *See* ECF No. 15, Ex. 13. The Court considered Exhibit F in full as it was obviously

a clerk's entry of default was entered on July 23, 2019 ("Default Entry"), accompanied by a notice of default informing the Smiths they had thirty days to file a motion to vacate the Default Entry and if no action was taken, the court may act promptly on any pending motions for entry of default judgment.

9. The Smiths filed a voluntary petition for Chapter 7 relief on July 25, 2019, which stayed the federal action prior to entry of any default judgment.

10. The Federal Complaint alleged the Smiths used the LLC as their alter ego to fund their lavish lifestyle and pay for personal expenses, including their residence, vehicles, and recreational activities. It also alleged Korey Smith took steps to divest the LLC of its assets while the state court litigation was pending and, therefore, the Smiths engaged in a course of action intended to defraud the Suters and shield themselves from liability by rendering the LLC judgment-proof and without assets.

11. The Suters allege all income of the LLC passed through directly to the Smiths and they used the LLC's funds to pay their personal expenses. They further allege that in an attempt to hide the income and disposition of assets of the LLC, the Smiths fraudulently transferred assets of the LLC to others pre-petition, did not file 2018 tax returns for themselves or the LLC, and withheld financial information from the Suters during post-judgment discovery in the state court action.

12. Although the Suters did not pursue a cause of action under § 727,[7] the Complaint includes allegations that the Smiths withheld information from the Chapter 7 Trustee during this bankruptcy case.

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intended. Other than these missing pages, the Court considered only the allegations found in the Complaint filed in this adversary proceeding.

[7] *See* 11 U.S.C. § 727(a)(2), (3), (4).

<u>APPLICABLE AUTHORITIES</u>

The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334(b) and 28 U.S.C. § 157. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

I. <u>STANDARD OF REVIEW</u>

Pursuant to Rule 12(b)(6), the Court must accept as true all of the factual allegations contained in the complaint, drawing all reasonable inferences in favor of the non-moving party. *E.I. du Pont de Nemours and Co. v. Kolon Indus., Inc.*, 637 F.3d 435, 440 (4th Cir. 2011) (citations omitted). A motion filed under Rule 12(b)(6) challenges the legal sufficiency of the complaint and provides that a party may move to dismiss for failure to state a claim upon which relief can be granted. The legal sufficiency of the complaint is measured by whether it meets the standards for a pleading set forth in Rule 8, which provides the general rules of pleading, and Rule 12(b)(6), which requires the complaint to state a claim upon which relief can be granted. *Francis v. Giacomelli*, 588 F.3d 186, 192 (4th Cir. 2009). Rule 8 requires the complaint contain "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2).

In order 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*, 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009) (quoting in *Bell Atl. Corp. v. Twombly*, 550 U.S. 554, 570, 127 S. Ct. 1955, 167 L.Ed.2d 929 (2007)). While the plausibility standard does not require "detailed factual allegations," *Twombly*, 550 U.S. at 555, 127 S. Ct. 1955, it does require the plaintiff demonstrate more than a "sheer possibility that a defendant has acted unlawfully." *Iqbal*, 556 U.S. at 678, 129 S. Ct. 1937. A complaint meets the plausibility standard when it "articulate[s] facts, when accepted as true, that 'show' that the plaintiff has stated a claim entitling him to relief, i.e., the 'plausibility of entitlement to relief.'" *Giacomelli*, 588 F.3d at 193 (quoting *Iqbal*, 556 U.S. at 678, 129 S. Ct. 1937). "Even though the requirements for pleading a proper complaint are substantially aimed at assuring that the defendant be given adequate notice of the nature of a claim being made against him, they also provide criteria for defining issues for trial and for early disposition of inappropriate complaints." *Id.* at 192, 129 S. Ct. 1937. To further demonstrate the plausibility standard, the Supreme Court stated the pleader must provide more than mere "labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 555, 127 S. Ct. 1955 (citations omitted).

A complaint asserting claims based on fraud is subject to a heightened pleading standard under Rule 9(b).[8] Under Rule 9(b), a party alleging fraud "must state with particularity the circumstances constituting fraud or mistake." "Rule 9(b) requires the identification of the 'circumstances constituting fraud'; it does not require 'any particularity in connection with an averment of intent, knowledge or condition of mind.'" *In re Warren*, 486 B.R. 704, 707 (D.S.C. 2013) (citations omitted). A "plaintiff must, at a minimum, describe the time, place, and contents of the false representations, as well as the identity of the person making the misrepresentation and what he obtained thereby . . . These facts are often referred to as the 'who, what, when, where, and how' of the alleged fraud." *U.S. ex rel. Wilson v. Kellogg Brown & Root, Inc.*, 525 F.3d 370, 379 (4th Cir. 2008) (internal quotations and citations omitted). "Mere allegations of 'fraud by hindsight' will not satisfy the requirements of Rule 9(b)." *Hillson Partners Ltd. P'ship v. Adage, Inc.*, 42 F.3d 204, 209 (4th Cir. 1994).

[8] Made applicable to this adversary proceeding by Fed. R. Bankr. P. 7009.

II. Prior Litigation and Preclusion

Under the doctrine of *res judicata* (or claim preclusion), "a final judgment on the merits bars further claims by parties or their privies based on the same cause of action." *Brown v. Felsen*, 442 U.S. 127, 131, 99 S. Ct. 2205, 2208, 60 L. Ed. 2d 767 (1979) (citing *Montana v. United States*, 440 U.S. 147, 153, 99 S. Ct. 970, 973, 59 L.Ed.2d 210 (1979)). The doctrine of *res judicata* serves to "prevent[ ] litigation of all grounds for, or defenses to, recovery that were previously available to the parties, regardless of whether they were asserted or determined in the prior proceeding." *Peugeot Motors of Am., Inc. v. E. Auto Distribs., Inc.*, 892 F.2d 355, 359 (4th Cir. 1989) (quoting *Brown*, 442 U.S. at 131, 99 S. Ct. 2205). "Generally, the preclusive effect of a judgment rendered in state court is determined by the law of the state in which the judgment was rendered." *Laurel Sand & Gravel, Inc. v. Wilson*, 519 F.3d 156, 161-62 (4th Cir. 2008).

> Under Maryland law, the elements of *res judicata*, or claim preclusion, are: (1) that the parties in the present litigation are the same or in privity with the parties to the earlier dispute; (2) that the claim presented in the current action is identical to the one determined in the prior adjudication; and, (3) that there has been a final judgment on the merits . . . If a final judgment exists as to a controversy between parties, those parties and their privies are barred from relitigating any claim upon which the judgment is based.

In re Durant, 586 B.R. 577, 584 (Bankr. D. Md. 2018) (quoting *Anne Arundel Cnty. Bd. of Educ. v. Norville*, 887 A.2d 1029, 1037 (Md. 2005)).

"Collateral estoppel is a doctrine of preclusion created to 'foreclose the relitigation of issues of fact or law that are identical to issues which have been actually determined and necessarily decided in prior litigation in which the party against whom [issue preclusion] is asserted had a full and fair opportunity to litigate.'" *In re McClendon*, 415 B.R. 170, 180 (Bankr. D. Md. 2009) (quoting *Sedlack v. Braswell Servs. Group, Inc.*, 134 F.3d 219, 224 (4th Cir. 1998)). "Maryland law . . . recognizes issue preclusion, or collateral estoppel, '[w]hen an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim.'" *In re Durant*, 586 B.R. 577, 584 (Bankr. D. Md. 2018) (quoting *Janes v. State*, 711 A.2d 1319, 1324 (Md. 1998)).

A defendant in default is not held to admit facts that are not well-pleaded, *DIRECTV, Inc. v. Pernites*, 200 F. App'x. 257 (4th Cir. 2006) (per curiam), or conclusions of law. *Ryan v. Homecomings Fin. Network*, 253 F.3d 778, 780 (4th Cir. 2001). "In short, despite occasional statements to the contrary, a default is not treated as an absolute confession by the defendant of his liability and of the plaintiff's right to recover." *Id.* (quoting *Nishimatsu Constr. Co., Ltd. v. Houston Nat'l Bank*, 515 F.2d 1200, 1206 (5th Cir. 1975)).

III. PIERCING THE CORPORATE VEIL

Maryland's Limited Liability Company Act states, "[e]xcept as otherwise provided by this title, no member shall be personally liable for the obligations of the limited liability company, whether arising in contract, tort or otherwise, solely by reason of being a member of the limited liability company." Md. Code Ann., Corps. & Ass'ns § 4A-301. It further provides that "[a] member of a limited liability company is not a proper party to a proceeding by or against a limited liability company, solely by reason of being a member of the limited liability company . . ." Md. Code Ann., Corps. & Ass'ns § 4A-302. Maryland law "recognize[s] the availability of an action to disregard a limited liability entity congruent with the equitable relief of piercing the corporate veil." *Serio v. Baystate Properties, LLC*, 60 A.3d 475, 483 (Md. App. 2013) (citing *McCleary v. McCleary*, 822 A.2d 460 (Md. App. 2002)).

Maryland courts permit corporate veil piercing upon either a showing of fraud or the need to enforce a paramount equity. *See Residential Warranty Corp. v. Bancroft Homes*

Greenspring Valley, Inc., 728 A.2d 783, 789 (Md. App. 1999). This standard has been narrowly construed. "Maryland is more restrictive than other jurisdictions in allowing a plaintiff to pierce a corporation's veil" and "a piercing of the veil for reasons other than fraud have failed in Maryland courts." *Id.* (internal quotations and citations omitted). Under Maryland law, the elements of fraud are:

> (1) That the defendant made a false representation to the plaintiff, (2) that its falsity was either known to the defendant or that the representation was made with reckless indifference as to its truth, (3) that the misrepresentation was made for the purpose of defrauding the plaintiff, (4) that the plaintiff relied on the misrepresentation and had the right to rely on it, and (5) that the plaintiff suffered compensable injury resulting from the misrepresentation.

Schlossberg v. Madeoy (In re Madeoy), 576 B.R. 484, 500 (Bankr. D. Md. 2017) (internal citation omitted).

There are three circumstances in which a corporate entity may be disregarded under Maryland law: (1) where the entity is used as a mere shield for the perpetration of a fraud; (2) if the member uses the entity to avoid legal obligations; and (3) if the member treats the entity's property as his own. *Rosen v. Kore Holdings, Inc. (In re Rood)*, 448 B.R. 149, 158 (D. Md. 2011). The third ground is referred to as the "alter ego" doctrine, which is applied "with great caution" and only "in exceptional circumstances." *Id.* at 159. Application of the alter ego doctrine is appropriate only if the plaintiff shows:

> (1) complete domination, not only of the finances, but of policy and business practice in respect to the transaction so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own
>
> (2) that such control [was] used by the defendant to commit fraud or wrong, to perpetrate the violation of the statutory or other positive legal duty, or dishonest and unjust act in contravention of the plaintiff's legal rights" and
>
> (3) that such "control and breach of duty proximately caused injury or unjust loss."

Id. (citations omitted). "The alter ego doctrine, then, is not a separate basis for piercing the veil, but is rather subsumed 'in the notion of paramount equity.' Therefore, in order to pierce the corporate veil, plaintiff's well-pleaded allegations and evidence must be tantamount to fraud or invoke a paramount equity." *Baltimore Line Handling Co. v. Brophy*, 771 F. Supp.2d 531, 552-53 (D. Md. 2011) (quoting *Hildreth v. Tidewater Equip. Co., Inc.*, 838 A.2d 1204, 1212-13 (Md. 2003)).

IV. 11 U.S.C. § 523

Section 523(a) provides, in relevant part, that a discharge under § 727 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;
>
> . . . .
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;
>
> . . . .
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity[.]

11 U.S.C. § 523(a). "One of the central purposes of the Bankruptcy Code is to provide the debtor with a 'fresh start.'" *In re Thoennes*, 536 B.R. 680, 694 (Bankr. D.S.C. 2015) (citing *Grogan v. Garner*, 498 U.S. 279, 286, 111 S. Ct. 654, 112 L. Ed.2d 755 (1991)). "In light of this, the Supreme Court has adopted a rule of construction that requires exceptions to discharge be interpreted narrowly." *Id.* (citing *Kawaauhau v. Geiger*, 523 U.S. 57, 62, 118 S. Ct. 974, 140 L. Ed.2d 90 (1998)).

The Supreme Court has distinguished between "false pretenses and representations" and "actual fraud" under § 523(a)(2)(A) and recognized two distinct paths for nondischargeability under this provision. *Husky Int'l. Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1586, 194 L. Ed. 2d 655 (2016). For a debt to be nondischargeable based on a false pretense or false representation, the creditor must prove:

> (1) that the debtor made a representation; (2) that at the time the representation was made, the debtor knew it was false; (3) that the debtor made the false representation with the intention of defrauding the creditor; (4) that the creditor justifiably relied upon the representation; and (5) that the creditor was damaged as the proximate result of the false representation.

In re Brush, 460 B.R. 448, 455-56 (Bankr. D.S.C. 2011). "A false pretense involves an implied misrepresentation or conduct that is intended to create and foster a false impression, while a false representation involves an express representation." *In re Scarlata*, 127 B.R. 1004, 1009 (N.D. Ill. 1991) (citing *In re Guy*, 101 B.R. 961, 978 (Bankr. N.D. Ind. 1988), *aff'd in part sub nom. Matter of Scarlata*, 979 F.2d 521 (7th Cir. 1992)). "A false representation or pretense requires a knowing and fraudulent falsehood that describes **past or current facts** and is relied upon by the other party." *In re Mileski*, 416 B.R. 210, 226 (Bankr. W.D.N.C. 2009) (emphasis in original). "The failure to perform a mere promise is not sufficient to make a debt nondischargeable, even if there is no excuse for the subsequent breach." *In re Goodale*, 604 B.R. 252, 254 (Bankr. D.S.C. 2019) (quoting 4 *Collier on Bankruptcy* ¶ 523.08 (16th ed. 2019)); *see also Strum v. Exxon Co.*, 15 F.3d 327, 331 (4th Cir. 1994) ("Because Strum has done nothing more than assert that Exxon never intended to honor its obligations under the March agreement, the district court's dismissal of the first cause of action was entirely appropriate."); *Mileski*, 416 B.R. at 225 ("[A] promise to perform acts in the future is not considered a qualifying misrepresentation merely because the promise subsequently is breached." (quoting *Allison v. Roberts (In re Allison)*, 960 F.2d 481, 484 (5th Cir. 1992))).

To establish a debt should be excepted from the discharge based on "actual fraud," the creditor must prove: (1) the debtor committed actual fraud; (2) the debtor obtained money, property, services, or credit by the actual fraud; and (3) the debt arises from the actual fraud. *Husky Int'l. Elecs.*, 136 S. Ct. at 1587-88. For fraud to be "actual," there must be wrongful intent; constructive or implied fraud is not actual fraud. *Id.* Regardless, "[a] plain reading of the subsection demonstrates that Congress excepted from discharge not simply any debt incurred as a result of fraud but only debts in which the debtor used fraudulent means to obtain money, property, services, or credit." *Nunnery v. Rountree (In re Rountree),* 478 F.3d 215, 219 (4th Cir. 2007).

Violations of a state's unfair or deceptive trade practices act do not automatically constitute fraud under § 523(a)(2)(A). *See In re Pereira*, 428 B.R. 276, 283 (Bankr. D. Mass. 2010) (rejecting the creditors' argument that the arbitrator's determination the contractor-debtor willfully and knowingly deceived them in violation of Massachusetts' Unfair Trade Practices Act was the equivalent to a finding that the debt was obtained by actual fraud or false pretenses because unfair trade practice violations and fraud are not synonymous and the former "can be founded on 'behavior that lacks the characteristics of misconduct necessary to support a finding of non-dischargeability' under 11 U.S.C. § 523(a)(2)(A)." (quoting *Stoehr v. Mohamed*, 244 F.3d 206, 208 (1st Cir. 2001))); *In re Wall-McMahel*, C/A No. 09-05754-8-JRL, 2010 WL 2901694, at *3 (Bankr. E.D.N.C. July 22, 2010) (finding the judgment under North Carolina's Unfair and Deceptive Trade Practices Act was not automatically nondischargeable under § 523(a)(2) because fraudulent intent is not considered under the state law); *In re Carino*, C/A No. ADV. 09-90017, 2010 WL 1049989, at *4 (Bankr. D. Haw. Mar. 17, 2010) ("Congress intended to except from the discharge claims based on common law fraud. Congress did not, however, intend to except from the discharge claims for violations of state statutes, even those that are intended to protect consumers. 'Section 523(a)(2)(A) was intended to codify case law as expressed in *Neal v. Clark*, 95 U.S. 704 (1878) which interpreted 'fraud' to mean actual or positive fraud rather than fraud implied by law.'" (quoting 4 *Collier on Bankruptcy* ¶ 523.08[1][e] (15th ed. rev. 2009))); *Tomlin v. Crownover (In re Crownover),* 417 B.R. 45 (Bankr. E.D. Tenn. 2009) (concluding the state court's judgment that the debtor-contractor engaged in deceptive acts under Tennessee's Consumer Protection Act does not establish two of the four elements of § 523(a)(2)); *Volumetrics Medical Imaging, Inc. v. ATL Ultrasound, Inc.*, 243 F. Supp.2d 386, 418 n.15 (M.D.N.C. 2003) ("Proof of fraud would necessarily constitute a violation of the prohibition against unfair and deceptive acts; however, the converse is not always true." (citing *Hardy v. Toler*, 218 S.E.2d 342 (N.C. 1975)).

Regarding § 523(a)(4), "[i]n the Fourth Circuit, the definition of 'fiduciary' is governed by federal common law and is strictly construed in dischargeability actions." *In re Hunnicutt*, 466 B.R. 797, 800 (Bankr. D.S.C. 2011) (citing *Arrow Concrete Co. v. Bleam (In re Bleam)*, 356 B.R. 642 (Bankr. D.S.C. 2006)). "In the building industry context '[a] variety of trust relationships do not meet the 'fiduciary' test of § 523(a)(4).'" *Bleam*, 356 B.R. at 649 (quoting 3 Bruner & O'Connor, *Construction Law* § 8:45). The term "fiduciary" under § 523(a)(4) "has been consistently limited to express trusts and not to trusts implied by law from contracts. 'The Courts have attempted to avoid making the exception so broad that it reaches such ordinary commercial relationships as creditor-debtor and principal-agent.'" *In re Anderson*, C/A No. 15-18781-WIL, 2018 WL 1475981, at *17 (Bankr. D. Md. Mar. 23, 2018), *aff'd,* 599 B.R. 504 (D. Md. 2019) (quoting *Spinosa v. Heilman (In re Heilman)*, 241 B.R. 137, 158 (Bankr. D. Md. 1999)).

The Maryland Custom Home Act provides "[a]ny consideration received by a custom home builder in connection with a custom home contract shall be held in trust for the benefit of the buyer. Payments made to subcontractors or suppliers in connection with the custom home contract shall be consistent with the trust." Md. Code Ann., Real Prop. § 10-502. The Maryland bankruptcy court previously determined this statute does not create a fiduciary relationship for purposes of § 523(a)(4). *Heilman*, 241 B.R. at 164, 169 ("[t]he relationship between a custom homebuilder and a custom homebuyer is an ordinary commercial relationship, even if one denominates the buyer as a consumer. There is no express or technical trust involved." Therefore, "the debtor custom home builder was not acting in a fiduciary capacity in relation to the plaintiffs . . . so as to render nondischargeable any debt owed by him to them because there was no express trust relationship between the parties that existed independently of the homebuilding contract.").

Even if a fiduciary relationship is established, the plaintiff must demonstrate the defendant committed fraud or defalcation. "For purposes of section 523(a)(4), fraud means 'positive fraud, or fraud in fact, involving moral turpitude or intentional wrong.' Similarly, defalcation means 'an intentional wrong' or 'a finding that the fiduciary consciously disregards (or is willfully blind to) a substantial and unjustifiable risk that his conduct will turn out to violate a fiduciary duty.'" *In re Vito*, 598 B.R. 809, 817 (Bankr. D. Md. 2019) (citations omitted).

Section 523(a)(6) requires not only that the debtor's act was intentional, but that the debtor engaged in the conduct with the "intent to injure." *Geiger*, 523 U.S. at 61, 118 S. Ct. 974.

> The Supreme Court and this court have decided that a debt arising from an injury attributable to mere negligent or reckless conduct does not satisfy the "willful and malicious" requirement of (a)(6); in addition, it is not enough that the conduct underlying the injury was intentional. Rather, the debtor must have engaged in such conduct with the actual intent to cause injury.

In re Muhs, 923 F.3d 377, 385 (4th Cir. 2019), *cert. denied sub nom. TKC Aerospace Inc. v. Muhs*, No. 19-293, 2019 WL 6689675 (Dec. 9, 2019); *see also Geiger*, 523 U.S. at 61, 118 S. Ct. 974 ("[N]ondischargeabilty takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury." (emphasis in original)); *Duncan v. Duncan (In re Duncan)*, 448 F.3d 725, 729 (4th Cir. 2006) ("Moreover, the mere fact that a debtor engaged in an intentional act does not necessarily mean that he acted willfully and maliciously for purposes of § 523(a)(6)." (citations omitted)).

DISCUSSION AND CONCLUSIONS

After careful consideration of the allegations of the Complaint (including its incorporated Exhibits) and applying applicable authorities and pleading standards, the Court finds the Suters' allegations insufficient to state a claim for relief to pierce the corporate veil or pursuant to § 523(a)(2), (4) or (6).

Before § 523(a)(2), (4) or (6) are relevant, the Complaint must plausibly allege the Smiths owe a debt or are responsible for a debt to the Suters.[9] The Suters seek to pierce the corporate veil of the LLC by alleging all income of the LLC passed through directly to the Smiths and they used funds of the LLC to pay their personal expenses. The Suters also allege

[9] Finding deficiencies in the allegations of the main Complaint to support this cause of action , the Court further considered each allegation of the incorporated Federal Complaint that led to the Default Entry.

Korey Smith took steps to divest the LLC of its assets while the state court litigation was pending in order to avoid legal obligations and to defraud the Suters. Despite these assertions, the Complaint fails to allege how the Smiths exercised complete domination, not only of the finances, but of the policy and business practices of the LLC so that it had no separate existence when the parties entered the Contract. Other than conclusory allegations, all allegations of the Complaint concerning the parties' interactions indicate Korey Smith was acting as an agent of the LLC, with whom the Plaintiffs made an agreement. Additionally, other than being a partial owner of the LLC, the Complaint fails to state any significant involvement of Stacy Smith with the alleged conduct here.

Even if the Court were to determine the Complaint contains sufficient allegations that the Smiths owe a debt to the Suters, the Complaint still fails to state a claim that such debt is nondischargeable. Despite the ample number of pages, the Complaint fails to plead with particularity the "who, what, when, where, and how" of any debt for money, property, services, or an extension, renewal, or refinancing of credit, obtained by any alleged fraud or misrepresentations – particularly by the Smiths individually. Although the Suters allege they relied on "fraudulent misrepresentations," they fail to state with specificity reliance on any particular representation that is actionable under § 523(a)(2). Their allegations of misrepresentation and fraud related to the alleged debt are conclusory and the Complaint merely asserts that failing to satisfy the terms of the Contract was fraudulent. Additionally, the Suters provide no legal support for their allegations of a general fiduciary relationship under Maryland law between them and either the LLC or the Smiths. Even if a fiduciary relationship did exist, the Suters have failed to adequately allege they are owed a debt, by the LLC or the Smiths, for fraud or any intentional wrongs or misrepresentations. Lastly, while the filing of the mechanic's lien may have been an intentional act that led to or could have led to an injury, the Complaint fails to allege that doing so was with the intent to injure the Suters and not merely an attempt to collect a debt allegedly owed to the LLC. Considering all allegations as true, the Suters have failed to state a claim pursuant to § 523(a)(2), (4) or (6).

The Suters' reliance on the Judgment against the LLC is inadequate. The Judgment is in favor of the Suters against the LLC, not the Smiths. Therefore, claim and issue preclusion are not applicable to bind the Smiths. Even if the Judgment was binding on the Smiths, an award under the Custom Home and Consumer Protection Acts is insufficient to support a cause of action under § 523(a), as such violations are not synonymous with fraud and differ from the elements of § 523(a). Further, there was no finding of fraud by the arbitrator or in the Judgment and a careful review of the Complaint indicates it fails to allege with detail any debt resulting from actionable fraud perpetrated by the Smiths either directly or through the LLC. To the extent the Suters attempt to rely on the Default Entry, allegations of the Smiths' mere failure to respond and the Default Entry are insufficient to support claim or issue preclusion in this Court for any purpose.

In summary, after a careful review of the 140-page Complaint, accepting as true all of the <u>factual</u> allegations contained in the Complaint, and drawing "all reasonable inferences" in favor of the Suters, and even assuming *arguendo*, the Court were to pierce the corporate veil, the Suters fail to state a claim for relief pursuant to § 523(a)(2), (4), or (6). While the allegations of the Complaint paint an unflattering picture of breach of contract and questionable business practices, they fall short on specific allegations necessary to state a claim for exception to discharge. The allegations merely include labels, conclusions, and formulaic recitations of essential elements of the causes of action, and the Complaint fails to adequately allege facts supporting the connection between the Smiths' specific conduct and any debt owed to the Suters by them that is for money, property, services, or an extension, renewal, or refinancing of credit, obtained by false pretenses, a false representation, or actual fraud; a debt for fraud or defalcation while acting in a fiduciary capacity; or a debt for willful and malicious injury by the Smiths to the Suters or to the property of the Suters.

IT IS, THEREFORE, ORDERED that the Complaint fails to state claim for relief and the Smith's Motion to Dismiss pursuant to Rule 12(b)(6) is granted.

FILED BY THE COURT
04/17/2020

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

Entered: 04/17/2020

Chief US Bankruptcy Judge
District of South Carolina