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United States Bankruptcy Court, S.D. Alabama.

IN RE: Jerry Dewayne GADDY, Debtor.
SE Property Holdings, LLC, Plaintiff,
v.
Jerry Dewayne Gaddy, Defendant.

Case No. 17-01568
|
Adversary Case No. 17-00054
|
Dated: January 5, 2018

Attorneys and Law Firms

Richard M. Gaal, McDowell, Knight, Roedder & Sledge, J. Alexander Steadman, Mobile, AL, for Plaintiff.

Lee R. Benton, Samuel Stephens, Birmingham, AL, for Defendant.

ORDER GRANTING MOTION FOR JUDGMENT ON THE PLEADINGS

HENRY A. CALLAWAY, CHIEF U.S. BANKRUPTCY JUDGE

*1 This adversary proceeding is before the court on the motion (doc. 16) for judgment on the pleadings filed by defendant/debtor Jerry Dewayne Gaddy ("Gaddy" or "debtor") with respect to the complaint objecting to discharge (doc. 1) filed by plaintiff SE Property Holdings, LLC ("SEPH" or "plaintiff") pursuant to 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(6). In summary, the debtor guaranteed in 2006 and 2008 substantial loans made by plaintiff's predecessor Vision Bank related to a real estate project which ultimately failed. Plaintiff contends that the debtor from 2009 through 2014 then undertook an extensive series of transfers of real and personal property to his wife and daughter or entities controlled by his family or him to avoid collection before ultimately filing for bankruptcy in 2017.

This court has jurisdiction under 28 U.S.C. §§ 1334(b) and 157 and the order of reference of the district court. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I), and the court has authority to enter a final order (the parties also so stipulated on the record at a scheduling conference on September 19, 2017). For the reasons discussed herein, the court grants the debtor's motion.

Background

Gaddy's debt to SEPH arose from the breach of Gaddy's personal guaranty of two business loans to Water's Edge, LLC related to an unsuccessful real estate project in Baldwin County, Alabama (the "project"). Gaddy executed personal guaranties for the two loans in 2006 and reaffirmed those obligations in 2008. Water's Edge defaulted on its obligation to SEPH's predecessor-in-interest Vision Bank in June 2010. SEPH filed suit against Gaddy and other guarantors in October 2010 in the Circuit Court of Baldwin County, Alabama. Gaddy's debt to SEPH was reduced to a judgment on December 17, 2014 in the amount of $9,168,468.14, although the Alabama Supreme Court later held that the judgment was not final because of one defendant's bankruptcy.[1] *See Gaddy v. SE Prop. Holdings, LLC*, 218 So. 3d 315, 324 (Ala. 2016).

SEPH alleges that from 2009 through 2014, with knowledge of Water's Edge potential and then actual default, Gaddy began transferring his property to family members and others. The following is a summary of pertinent events from SEPH's complaint:

12/5/2006	First loan to Water's Edge (#98809) for $10 million
11/28/2006	Gaddy's unlimited guaranty for Loan 1
12/5/2006	Second loan to Water's Edge (#98817) for $4.5 million
11/28/2006	Gaddy's limited guaranty for Loan 2 (limited to $84,392)
4/25/2008	Gaddy reaffirms guaranty of Loan 1 with principal increase to $12.5 million

4/25/2008	Gaddy reaffirms limited guaranty of Loan 2
March 2009	It becomes clear that the project will not be completed on time
3/13/2009	Guarantors begin missing capital contributions
May 2009	First guarantors file for bankruptcy
10/3/2009	Letter to guarantors from the bank regarding upcoming payment and potential default
10/16/2009	Gaddy deeds Marengo County, Alabama parcels to Rembert, LLC
10/30/2009	Rembert, LLC formed per Secretary of State with debtor, wife Sharon, and daughter Elizabeth as members
11/2/2009	Gaddy transfers 46% of Gaddy Electric & Plumbing, LLC to his wife Sharon
11/20/2009	Gaddy quitclaims three Marengo County parcels to his wife Sharon
June 2010	Water's Edge defaults on both Loans and the bank demands payment from Gaddy pursuant to his guaranties
10/4/2010	Gaddy conveys real property (110 Barley Avenue) to daughter Elizabeth
10/11/2010	SEPH files lawsuit against Water's Edge and guarantors, including Gaddy, in Baldwin County Circuit Court
2/23/2012	SLG Properties, LLC ("SLG") formed by Gaddy's wife Sharon
4/18/2012	Gaddy conveys real property (145 Industrial Park) to SLG
4/18/2012	Gaddy conveys real property (179 Industrial Park) to SLG
11/17/2014	Baldwin County Circuit Court judgment against Gaddy and other guarantors for $9.1 million (later held on appeal to not be final)
11/23/2014	Gaddy transfers $293,945.51 to Gaddy Electric
12/15/2014	Gaddy transfers 41% interest in Gaddy Electric to his wife Sharon
4/26/2017	Gaddy files the above-captioned chapter 7 bankruptcy

Standard

*2 Pursuant to Federal Rule of Civil Procedure 12(c), made applicable by Federal Rule of Bankruptcy Procedure 7012, a party may move for judgment on the pleadings after the pleadings are closed. "Judgment on the pleadings is appropriate when there are no material facts in dispute and

the moving party is entitled to judgment as a matter of law." *Douglas Asphalt Co. v. Qore, Inc.*, 541 F.3d 1269, 1273 (11th Cir. 2008). "All facts alleged in the complaint must be accepted as true and viewed in the light most favorable to the nonmoving party." *Id.* In deciding the motion, "the court considers the complaint, answer[ ], and the exhibits thereto." *See Barnett v. Baldwin Cty. Bd. of Educ.*, 60 F. Supp. 3d 1216, 1224 (S.D. Ala. 2014).

Discussion

SEPH alleges that the transfers by Gaddy outlined above "were actually fraudulent as to SEPH as they were made to hinder SEPH's collection of its debt owed by" Gaddy, and that Gaddy's "actual fraud in connection with these fraudulent transfers is an exception to discharge to the extent of those transfers under" § 523(a)(2)(A). (*See* Compl., doc. 1, at ¶¶ 69-71). It also contends that in making the transfers Gaddy "willfully and maliciously injured SEPH and/or the property of SEPH[,]" and that "such conduct creates an exception to discharge to the extent of those transfers under" § 523(a)(6). (*See id.* at ¶¶ 73-75). It requests that the court declare its debt nondischargeable pursuant to §§ 523(a)(2)(A) and 523(a)(6).

In its motion for judgment on the pleadings, Gaddy contends that SEPH's allegations do not state a claim under either § 523(a)(2)(A) or § 523(a)(6). SEPH filed a response to the motion, Gaddy filed a reply, SEPH filed a sur-reply, and the court heard extensive oral argument.

I. *BancorpSouth Bank v. Shahid*

The court is not writing on a blank slate; it has considered the issues raised by Gaddy's motion in the case of *BancorpSouth Bank v. Shahid*, Adversary Proceeding No. 16-03009, while sitting as a visiting judge in the U.S. Bankruptcy Court for the Northern District of Florida, Pensacola Division. In *Shahid*, the creditor obtained state court judgments totaling $1.8 million against the debtor, who then undertook a series of allegedly fraudulent transfers to avoid collection. The undersigned granted the debtor's motion to dismiss the bank's nondischargeability actions under 11 U.S.C. §§ 523(a)(2) and 523(a)(6). The bank appealed, and the district court affirmed. *See BancorpSouth Bank v. Shahid*, No. 3:16cv621-RV/EMT (N.D. Fla. 2017). In addition to the district court's affirmance, at least one other court has adopted this court's holding in *Shahid*. *See, e.g.*, *In re Wilson*, No. 16-3068, 2017 WL 1628878, at *8 (Bankr. N.D. Ohio May 1, 2017) (citing this court's *Shahid* opinion with approval); *see also In re Vanwinkle*, 562 B.R. 671, 677-78 (Bankr. E.D. Ky. 2016) (reaching same conclusion as *Shahid*). Because the bankruptcy's and district court's opinions in *Shahid* are not reported, copies are attached as Exhibits A and B, and those opinions are incorporated as if set out fully herein.

II. SEPH's allegations

SEPH contends that the *Shahid* opinions were wrongly decided or can be distinguished on the facts. The court discusses SEPH's arguments below.[2]

A. Bankruptcy Code § 523(a)(6)

Bankruptcy Code § 523(a)(6) creates an exception to discharge "for willful and malicious injury by the debtor to another entity or to the property of another entity ...." As discussed in this court's *Shahid* opinion, other courts have held that a debtor's actions after a debt has been incurred cannot support a § 523(a)(6) claims because the "injury" is the underlying debt. *See Shahid* op., Ex. A hereto, at pp. 2-3. This reasoning is also dispositive here. The underlying debt is the result of personal guaranties, not any willful and malicious injury by Gaddy. The parties' disagreement about whether or not the state court judgment based on the guaranties is a final judgment is immaterial; even if the judgment is final, the "injury" is still the debt underlying the judgment. *In re Jennings*, 670 F.3d 1329 (11th Cir. 2012) is distinguishable because the "injury" there arose from the fraudulent transfer itself by the application of California state law. *See Shahid* op., Ex. A hereto, at pp. 3-4.

*3 The only debt that SEPH seeks to have declared nondischargeable in its complaint is the state court judgment based on the guaranties. (*See* Compl., doc. 1, at pp. 14-15). Nevertheless, SEPH's counsel argued in brief and at oral argument that it is not only the underlying guaranties that SEPH seeks to have declared nondischargeable but also a subsequent liability created by Gaddy's allegedly fraudulent transfers.[3] SEPH contends that it suffered a separate "injury" to it or its property under § 523(a)(6) in the form of Gaddy's liability to it under Alabama law for the fraudulent transfers described in the complaint. In this respect, SEPH urges the

court to adopt the dicta in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), (*see* SEPH Resp., doc. 25, at p.6), suggesting that a debtor/transferor who transfers property with the intent to defraud creates a new, nondischargeable debt for the value of the transferred property. Thus, the court must examine whether Alabama law supports such a claim.

Alabama Code § 8-9A-7 sets out the remedies available to creditors under Alabama's Uniform Fraudulent Transfer Act ("AUFTA"):

> (1) Avoidance of the transfer to the extent necessary to satisfy the creditor's claim;
>
> (2) An attachment or other provisional remedy against the asset transferred or other property of the transferee in accordance with the procedure prescribed by any applicable provision of any other statute or the Alabama Rules of Civil Procedure;
>
> (3) Subject to applicable principles of equity and in accordance with applicable rules of civil procedure,
>
> a. An injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;
>
> b. Appointment of a receiver to take charge of the asset transferred or of other property of the transferee; or
>
> c. Any other relief the circumstances may require.

Although the statute specifically states that the creditor's remedies are not limited to those listed, SEPH has not provided any Alabama law that the debtor/transferor who fraudulently transfers property is liable to a creditor for the value of the transferred property. In Alabama, if a court avoids a fraudulent transfer under Alabama Code § 8-9A-7, title does not revest in the debtor; "[i]nstead, the transferee continues to own the fraudulently transferred assets [and] the transfer is void only as to the creditor, and the creditor can execute on those assets directly" under Alabama Code § 8-9A-7(b). *See Ex parte HealthSouth Corp.*, 974 So. 2d 288, 297 (Ala. 2007); *SE Prop. Holdings, LLC v. Center*, No. 15-0033-WS-C, 2017 WL 3403793, at *34 (S.D. Ala. Aug. 8, 2017). Because title remains with the transferee, Alabama law "creates a remedy for the creditor" against the transferee for "(i) a money judgment ... for the lesser of the value of the asset at the time of transfer or 'the amount necessary to satisfy the creditor's claim;' or (ii) a judgment ... for conveyance of the asset itself." *See SEPH v. Center*, 2017 WL 3403793, at *34 (citing Ala. Code § 8-9A-8(b)). Alabama law does not contemplate a similar claim against the transfer or, though, as Gaddy is here.[4]

The Alabama Supreme Court did affirm a conspiracy-to-defraud money judgment against a debtor-transferor in *Johns v. T.T. Stephens Enterprises*, 815 So. 2d 511, 516-17 (Ala. 2001). However, the damages awarded against the debtor-transferor were profits which the plaintiff lost as a result of the debtor's inability to perform its contract with the plaintiff because of the fraudulent conveyances, not the value of the transferred property itself as SEPH seeks here. *See id.* at 517. In this district, District Judge William H. Steele recently declined to award SEPH monetary damages against a debtor/transferor because, among other reasons, SEPH had not proven any consequential damages that were the "natural and proximate result of the [borrower and his wife]'s conspiracy to fraudulently transfer assets beyond its reach." *See SEPH v. Center*, 2017 WL 3403793, at *34. In other words, in both those cases, the fraudulent transfer itself did not create a damages claim against the debtor/transferor under AUFTA. SEPH has not alleged in its complaint, briefs, or oral argument that it has suffered damages as a result of the alleged fraudulent transfers, other than the original contractual debt or the value of the transferred property.

*4 Furthermore, it is unclear how creating a separate monetary liability on the part of a debtor/transferor for the value of the transferred property would work under SEPH's theory. Assume a debtor owed a specific creditor $100,000 and fraudulently transferred property worth $20,000; does he now owe the creditor both amounts, for a total of $120,000? If the debtor has ten creditors, does he have a separate liability to each creditor for the $20,000 value of fraudulently transferred property, for a total of $200,000 ($20,000 x 10 creditors)? Is the debtor liable for money damages to even future creditors under Alabama Code § 8-9A-4? In the absence of any law supporting this theory, the court declines to find that an alleged fraudulent transfer in itself creates an "injury" to an individual creditor by the debtor/transferor that would support a § 523(a)(6) claim.

Finally, as it did in *Shahid*, the court also finds that SEPH cannot sustain a claim under § 523(a)(6) for damage to its property because it has not alleged a security interest, judgment lien, or any other interest in any of the transferred

properties. SEPH's inchoate right to collect did not constitute its "property" under § 523(a)(6). *See Shahid* op., Ex. A hereto, at p.3. If the transfers were to SEPH's detriment, it was a detriment that was not specific to itself and that it suffered with all of Gaddy's creditors – both existing and future.

B. Bankruptcy Code § 523(a)(2)

Bankruptcy Code § 523(a)(2) states in pertinent part that a debtor is not discharged "from any debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... actual fraud, other than a statement respecting the debtor's or an insider's financial condition ...." (emphasis added). SEPH does not contend that the underlying debt from the guaranties was obtained by fraud or was anything other than a standard contract debt. Instead, it relies on the U.S. Supreme Court's decision in *Husky International Electronics, Inc. v. Ritz*, 136 S. Ct. 1581 (2016), to argue that Gaddy's alleged fraudulent transfer "scheme" after incurring the underlying debt entitles it to have its debt declared nondischargeable under § 523(a)(2). While *Husky* potentially expanded the universe of § 523(a)(2) causes of action against transferees, it does not reach as far as SEPH argues for the same reasons outlined in *Shahid*. *See Shahid* op., Ex. A hereto, at pp. 4-5; *see also, e.g.*, *In re Vanwinkle*, 562 B.R. at 677-78.

SEPH argues that Gaddy was essentially both transferor and transferee, and thus the distinction that this court made in *Shahid* should not apply. However, the court is unaware of any bankruptcy or state law to support a cause of action to set aside a transfer as fraudulent where the same person is both the transferor and transferee which would support a § 523 claim. For example, if SEPH contends that Gaddy controls Gaddy Electric through his family such that Gaddy Electric should be part of the debtor's bankruptcy estate, then it needs to work with the chapter 7 trustee to bring that company into the estate; its remedy is not to have its debt declared nondischargeable under § 523. *In re Bilzerian*, 100 F.3d 886 (11th Cir. 1996), cited by SEPH, did not involve alleged fraudulent transfers and is otherwise distinguishable from the situation presented here.

SEPH further tries to distinguish *Shahid* on the ground that SEPH had filed a fraudulent transfer action against the debtor in district court, which action was stayed by the filing of the bankruptcy case. SEPH argues that it would have obtained a money damages award against Gaddy in the fraudulent transfer action for the value of the transferred property. However, as discussed above in conjunction with SEPH's § 523(a)(6) claim, it has not pointed to any Alabama law which would create a "debt for money, property, services, or an extension, renewal, or refinancing of credit" in favor of a creditor against a debtor/transferor based solely on the value of the fraudulently transferred property.

*5 SEPH's argument that "even a transferor should be subject to § 523(a)(2) to the extent of their fraud[,]" (*see* SEPH Resp., doc. 25, at p.6), ignores that fraudulent transfers such as those alleged here are an offense against all creditors, present and future. Gaddy's schedules reflect significant unsecured debt other than that of SEPH, including $1.631 million owed to Union State Bank, and $784,991 owed to West Alabama Bank & Trust. Under Alabama law, transfers made by a debtor with the actual intent to hinder, delay, or defraud any creditor can be set aside even as to future creditors whose claims did not arise until after the transfers took place. *See* Ala. Code § 8-9A-4. Under bankruptcy law, the chapter 7 trustee can file actions to set aside such transfers and bring those assets into the bankruptcy estate for the benefit of all creditors, if warranted, and those assets will then be liquidated for the benefit of all creditors based upon the priority scheme set out in the Code. *See* 11 U.S.C. § 548. As discussed above, to the extent that the Seventh Circuit dicta cited by SEPH from *McClellan*, 217 F.3d 890, suggests that a debtor/transferor could create a new, nondischargeable debt to one creditor in the amount of the allegedly fraudulently transferred property that would support a claim under § 523(a)(2), the court declines to follow that suggestion under Alabama or bankruptcy law. And in *McClellan*, the creditor had a security interest (although unperfected) in the transferred assets. *See id.* at 892. Here, SEPH has never contended that it had a security or other interest in the transferred items. *See, e.g.*, *In re Wigley*, 533 B.R. 267, 273 (B.A.P. 8th Cir. 2015) (distinguishing *McClellan* on that basis).

Bankruptcy Code § 727(a)(2)(A) bars the discharge of a debtor who has transferred his property with intent to hinder, delay, or defraud creditors within a year of the bankruptcy petition. A holding that a debtor is not entitled to a discharge under this section benefits all creditors. But to hold that a single unsecured creditor like SEPH can have its debt

declared nondischargeable under § 523(a)(2)(A) because of allegedly fraudulent transfers which took place long after its debt arose (and which affect all unsecured creditors equally) would conflate and confuse that section with § 727(a)(2).

Finally, the court is not persuaded by SEPH's attempt to distinguish *Shahid* on the ground that, unlike in *Shahid*, the transfers here took place before the creditor obtained a state court judgment against debtor. Although the fact that the transfers in *Shahid* took place after the judgments had already been entered added color to the point that the judgments were not "obtained by" the alleged fraud, all that is required under § 523(a)(2) is that the extension of credit arose as a result of fraud – not the judgment being entered on the extension of credit. [5]

Conclusion

To the extent the court has not specifically addressed any of the parties' arguments, it has considered them and determined that they would not alter the result. For the reasons discussed above, Gaddy is entitled to judgment as a matter of law on SEPH's claims brought pursuant to 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(6). Therefore, the court grants the debtor's motion (doc. 16) for judgment on the pleadings and will enter a separate order dismissing the adversary proceeding.

EXHIBIT A

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF FLORIDA

PENSACOLA DIVISION

In Re: CARY PAUL SHAHID, Debtor.

BANCORPSOUTH BANK, Plaintiff,

v.

CARY PAUL SHAHID, Defendant.

Case No. 15-30868-HAC

Adv. Proc. No. 16-03009

OPINION

This adversary proceeding is before the Court on the defendant debtor's motion (doc. 41) to dismiss the amended complaint seeking exception from discharge. The plaintiff obtained substantial state court judgments against debtor and alleges that the debtor then undertook a variety of transfers and other actions to avoid collection. The legal issue is whether the debtor's alleged fraudulent transfers and other actions taken after the judgments will support a claim that the judgments are non-dischargeable pursuant to Bankruptcy Code §§ 523(a)(2) and/or (6). For the reasons stated below, the Court finds that they do not.

This Court has jurisdiction under 28 U.S.C. §§ 1334(b) and 157 and the order of reference of the district court. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I), and this Court has authority to enter a final order.

*6 The amended complaint (doc. 24) alleges that in September and October 2011 BancorpSouth Bank ("BCS") obtained two final judgments totaling over $1.8 million against debtor Cary Shahid in Florida state court based on defaulted promissory notes he personally guaranteed. [Doc. 46, ¶ 1.] BCS alleges that Shahid thereafter undertook a host of activities to thwart collection efforts, including setting up new corporate entities and diverting funds into accounts owned by those entities (doc. 24, ¶ 4); causing money owed to him to be paid to another corporation (id., ¶ 5); and causing funds of a corporation in which he owned a 60% interest to be paid to a shell corporation, his girlfriend, other creditors, and himself (id., ¶¶ 7-13).

To withstand a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), which is applicable pursuant to Federal Rule of Bankruptcy Procedure 7012, a complaint must contain sufficient factual material to state a claim for relief that is plausible on its face. Ashcroft v. Iqbal, 566 U.S. 662, 129 S.Ct. 1937, 1949 (2009). In considering a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), the court must accept all factual allegations (although not legal conclusions) in the complaint as true. Id., 129 S.Ct. at 1949-50.

Bankruptcy Code § 523(a)(6) creates an exception to discharge "for willful and malicious injury by the debtor to another entity or to the property of another entity ...." Other courts have held that a debtor's actions which occurred after the debt had been incurred or, as here, after judgment on the debt had already been entered, cannot support a § 523(a)(6) claim because the "injury" is the underlying debt. For example, in In re Best, 109 Fed. Appx. 1 (6th Cir. 2004), the Sixth Circuit held that a debtor's postjudgment efforts to thwart collection of a judgment debt did not render that debt nondischargeable because it was not the postjudgment actions which gave rise to the debt. The facts alleged in this case are similar to those in In re Kirwan, No. 15-14012-MSH, 2016 WL 5110677 (Bankr. D. Mass. 2016). The plaintiffs there obtained substantial state court judgments against the debtor and a corporation he owned; the debtor then set up another corporation and transferred the old corporation's business and assets to the new one. The court rejected the § 523(a)(6) claim based on transfers occurring after the state court judgment:

> As was the case in Best [supra], the conduct alleged in Count III occurred after the judgments were entered. Thus, any injury resulting from the alleged transfers could not have given rise to the debt at issue, and therefore any injury--even if willful and malicious--cannot render the amount due under the state court judgments nondischargeable under Bankruptcy Code § 523(a)(6).

Id. at *4. The court found that the § 523(a)(6) claims also failed because the plaintiffs did not have any interest in the property that was allegedly fraudulently transferred. Id. at *4. See also Rockstone Capital, LLC v. Walker-Thomas Furniture Co., et al, No. 04-01581, 2007 WL 2071626 (Bankr. D.D.C. 2007) (postjudgment transfers of property on which creditor did not have a lien insufficient for § 523(a)(6) claim).

BCS alleges that Shahid injured its "right to recover amounts he owes it and its right to collect on its judgments." [Doc. 24, ¶ 15.] However, hindering the bank's inchoate "right to recover" or "right to collect" does not constitute a separate injury to it or its property under § 523(a)(6). See In re Saylor, 108 F.3d 219, 221 (9th Cir. 1997) (creditor's potential fraudulent transfer remedies do not constitute "debt" or "property" under § 523(a)(6)).

The cases cited by BCS are distinguishable because they do not involve situations, as here, where the debt sought to be nondischargeable arose before the transfers complained of and the creditor did not have an interest in the transferred property. The creditor's § 523(a)(6) claim against the debtor in In re Jennings, 670 F.3d 1329 (11th Cir. 2012), arose from the fraudulent transfer itself. The creditor had already obtained a fraudulent transfer judgment of $3.9 million before filing the § 523(a)(6) case, and it was that fraud judgment, not the related tort claim judgment of $24.8 million, which was held nondischargeable. The Eleventh Circuit distinguished Saylor, supra, by noting that the creditor there, as here, did not already have a fraudulent transfer judgment. 670 F.3d at 1333-34. In In re Monson, 522 B.R. 721 (Bankr. N.D. Fla. 2015), the debtor had contractually agreed to liquidate his company's equipment to repay a creditor if the business was not profitable; instead, he opened a new business and moved the equipment to his new business. Unlike the case at hand, the creditor had an interest in the transferred property (reflected by a potentially defective financing statement), and the debtor fraudulently breached his separate obligation to surrender the collateral. Similarly, in In re Garcia, 442 B.R. 848 (Bankr. M.D. Fla. 2011), the debtor agreed to give the home equity lender a security interest in real property but quickly sold it before the mortgage could be recorded and the security interest perfected. The debtor's fraudulent transfer of the bank's collateral was a separate injury to the creditor's property interest which supported a § 523(a)(6) claim. Id. at 852.

*7 Because (1) the debtor's "injury" to BCS resulted from promissory notes and guaranties executed and reduced to judgment before the alleged fraudulent transfers and other activities took place and (2) BCS has not alleged any direct injury to itself or any property in which it held an interest, the Court finds that the motion to dismiss should be granted as to the § 523(a)(6) claim.

BSC's amended complaint also contains a claim for nondischargeability under Code § 523(a)(2). Section 523(a)(2)(A) provides that a debtor is not discharged "from any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud, other than a statement representing the debtor's or an insider's financial condition ...." [Emphasis added.] The U.S. Supreme Court recently held in Husky Int'l Electric, Inc. v. Ritz, 136 S. Ct. 1581 (2016), that a course of action may constitute fraud under this section and that a specific fraudulent statement is not required. However, the court in Husky did not eliminate the "obtained by" requirement of § 523(a)(2)(A); the individual debtor in Husky was not liable on the original trade debt, and his liability to the creditor arose from the fraudulent transfers he caused the original corporate obligor to make. Husky in dicta may open the door for potential § 523(a)(2) claims against debtor-transferees who have received fraudulently transferred assets. See Deborah Thorne & Brett Newman, What's Next After Husky v. Ritz: Has Pandora's Box Been Opened?, 35 Am. Bank. Inst. J. 20 (2016). However, debtor Shahid here is the alleged fraudulent transferor; with exception of some assets of Eastern Lake Restaurant (doc. 24, ¶ 4), he is alleged to have fraudulently transferred his own assets.

The Supreme Court in Husky did not rule on the "obtained by" issue and remanded the case for further proceedings on that issue. The case at hand differs because Mr. Shahid was already obligated on the original debt, which is the debt plaintiff seeks to have declared nondischargeable. The debtor in Husky was not; his liability arose from the alleged fraudulent transfer. This Court is not willing to extend the Husky dicta to find that debts "obtained by" Shahid's guaranty of promissory notes and then reduced to judgment can somehow be "re-obtained" and thus rendered nondischargeable by later alleged fraudulent actions.

The two judgments against debtor totaling $1.8 million described in the complaint arose from defendant's guaranty of promissory notes, not from any fraud and not from the alleged later fraudulent transfers and other activities complained of. The debts represented by the judgments were thus not "obtained by" fraud -- whether a course of action or fraudulent statement. Even if the "obtained by" fraud requirement was potentially expanded in Husky, where the debtor's liability arose not from the original debt but his later fraudulent transfers, the judgments which the bank seeks to have declared non-dischargeable do not meet that standard.

For the reasons stated above, the Court will enter a separate order granting the motion to dismiss the amended complaint.

Dated: November 3, 2016

EXHIBIT B

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF FLORIDA

PENSACOLA DIVISION

BANCORPSOUTH BANK, a Mississippi banking corporation, Appellant,

***8** v.

CARY PAUL SHAHID, Appellee.

Case No.: 3:16cv621-RV/EMT

ORDER

In September and October 2011, BancorpSouth Bank (BCS) obtained two final judgments totaling over $1.8 million against Cary Paul Shahid in Florida state court based on defaulted promissory notes that he personally guaranteed. BCS contends that Shahid thereafter engaged in various acts and fraudulent transfers to thwart collection efforts. On August 21, 2015, Shahid filed a petition for bankruptcy under Chapter 11 of the Bankruptcy Code, and BCS filed an adversary proceeding seeking to except its claims against Shahid from discharge, pursuant to Bankruptcy Code §§ 523(a)(2)(A) and/or 523(a)(6).[1] By written order dated November 3, 2016, the Bankruptcy Court (Judge Henry A. Callaway) granted Shahid's motion to dismiss the complaint, holding that his purported fraudulent transfers and other acts to avoid collection—which were taken *after* BCS's state court judgments—do not render the debts non-dischargeable under Section 523(a)(2)(A) and/or Section 523(a)(6). BCS has filed this appeal.

District courts function as appellate courts in reviewing decisions reached by bankruptcy courts. *See, e.g.*, *In re*

Graupner, 537 F.3d 1295, 1299 (11th Cir. 2008) ("In a bankruptcy case, the district court functions as an appellate court ....") (Vinson, J.); *In re Colortex Indus. Inc.*, 19 F.3d 1371, 1374 (11th Cir. 1994) (noting same). I review the Bankruptcy Court's legal conclusions *de novo*, but I must accept the Bankruptcy Court's findings of fact unless they are clearly erroneous. *See In re JLJ Inc.*, 988 F.2d 1112, 1116 (11th Cir. 1993).

After full review, I agree with Judge Callaway for all the reasons articulated in his order. As Shahid has succinctly and persuasively noted in his brief on this appeal, the fundamental error in BCS's position is the lack of a critical element in both its claim for relief under Section 523(a)(2)(A) and Section 523(a)(6)—to wit, the nexus between the "debt" and the allegedly improper conduct. As to the former statute, the debt that BCS seeks to except from Chapter 11 discharge are the two pre-petition state court judgments that were rendered against Shahid based upon his promissory note guarantees. *That* debt was not a "debt for money, property, services, or an extension, renewal or refinancing of credit *to the extent obtained by ... actual fraud*" as required under Section 523(a)(2)(A). *See In re Wilson*, 2017 WL 1628878, at *8 (Bankr. N.D. Ohio 2017) ("The evidence is that all of the [allegedly fraudulent transfers of property and assets] occurred after the judgment against Defendant in the State Court Action was entered. Any injury ... arising from the alleged fraudulent transfer(s) could not have given rise to the judgment debt at issue.") (citing and discussing multiple cases, including *In re Vanwinkle*, 562 B.R. 671 (Bankr. E.D. Ky. 2016) (judgment debt for contract damages not rendered non-dischargeable by allegedly fraudulent scheme to frustrate collection efforts)).[2]

***9** Nor was the debt a "debt for" willful and malicious injury by Shahid to another entity, or to the property of another entity, as required by Section 523(a)(6). *See, e.g.*, *In re Best*, 109 Fed. Appx 1, 5 (6th Cir. 2004) (acknowledging the evidence in that case suggesting the Bests willfully disposed of assets to avoid repaying Steier; concluding, however, that does not render the debt nondischargeable under § 523(a)(6): "Even if the Bests disposed of or concealed assets in a way they knew would prevent Steier from collecting the judgment debt, it is of no avail to Steier because the concealment occurred *after* that debt arose. Thus the concealment could not have caused or given rise to the judgment debt, as required for nondischargeability under § 523(a)(6).") (emphasis in the original).[3]

Accordingly, the decision and judgment rendered by the Bankruptcy Court on November 3, 2016, is hereby AFFIRMED.

DONE and ORDERED this 28th day of September 2017.

/s/

ROGER VINSON Senior United States District Judge

All Citations

Slip Copy, 2018 WL 10345329

Footnotes

1 SEPH and Gaddy disagree as to whether the judgment is now final. As discussed by the court at oral argument and below, the finality or non-finality of the state court judgment does not affect the court's analysis.

2 Several of SEPH's arguments blur the lines between §§ 523(a)(6) and 523(a)(2). The court's analysis in each section below applies with equal force to both claims, regardless of the section in which the analysis is included.

3 The court has considered this argument even though it is not specifically pleaded in the complaint. For this reason, the court does not find it necessary to allow amendment under Federal Rule of Civil Procedure 15, incorporated by Federal Rule of Bankruptcy Procedure 7015.

4 The court discusses SEPH's argument that Gaddy was in essence both transferee and transferor below in conjunction with SEPH's § 523(a)(2) claim.

5 Although not argued in conjunction with the § 523(a)(6) claim, this analysis similarly applies to the "injury" element of that claim.

1 Section 523(a) provides, in relevant part, that:

> A discharge under [Chapter 11] 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;
> ... (6) for willful and malicious injury by the debtor to another entity or to the property of another entity[.]

2 In *Husky Int'l Electronics v. Ritz*, — U.S. —, 136 S. Ct. 1581 (2016), the Supreme Court suggested in dicta that Section 523(a)(2) might permit claims against debtor transferees who have received fraudulently transferred assets. However, as Judge Callaway correctly noted, that dicta has no bearing where—as here—the debtor is the purported fraudulent transfer *or*. *In re Wilson, supra*, 2017 WL 1628878, at *8 (citing Judge Callaway's decision in this case with approval and stating: "while *Husky* in dicta may open the door wide for § 523(a)(2) claims against debtor-transferees who have received fraudulently transferred assets, the Defendant here is the alleged transferor of his own property").

3 In *In re Best*, the Sixth Circuit cited with approval *In re Smith*, 249 B.R. 748 (Bankr. S.D. Ohio 2008), wherein the bankruptcy court stated:

> For a debt to fall within this exception to discharge, the creditor has the burden of proving that it sustained an injury *as a result* of a willful and malicious act by the debtor. Thus, a debtor's actions must be determined to be the cause of the creditor's injury. In this case, there is no dispute that the creditor's "injury," the deficiency balance, is a pre-petition debt. Even if the Debtors' alleged post-petition actions to thwart repossession of the creditors' security are proven true, they cannot be the cause of the creditor's pre-petition claim. Consequently, these actions do not form the basis for declaring the deficiency debt nondischargeable under § 523(a)(6).

Id. at 750 (emphasis in the original).

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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

SE Property Holdings, LLC.,	)	
	)	
Appellant,	)	
	)	
v.	)	**CIVIL NO. 1:18-CV-00027**
	)	
Jerry Dewayne Gaddy,	)	
	)	
Appellee.	)	

ORDER

This matter is before the court on SE Property Holdings LLC's ("SEPH" or "Appellant") appeal of an order from the U.S. Bankruptcy Court for the Southern District of Alabama. For its determination, the court has considered each party's respective brief(s) (Docs. 10 – 12), as well as the complete record of the adversarial proceedings from the Bankruptcy Court (Doc. 6). For the reasons stated herein, the Bankruptcy Court's order granting Appellee's Motion for Judgment the Pleadings is **AFFIRMED.**

I. Background

According to the record, SEPH filed the complaint objecting to discharge that birthed the instant appeal on July 7, 2017. In its complaint, SEPH provided a chronological account of events that led the parties to their present status before the court. Those events are briefly summarized as follows. On December 5, 2006, SEPH's predecessor in interest ("Bank") issued two loans to Water's Edge, LLC, to fund the construction of a real estate project in Baldwin County, Alabama, ("Water's Edge project"). The first loan ("first loan") totaled $10 million. Jerry Dewayne Gaddy

("Appellee" of "Gaddy") acted as a guarantor for that loan, executing a Continuing Unlimited Guaranty Agreement to that effect on November 28, 2006. The second loan ("second loan") for the project amounted to $4.5 million. For the second loan, Appellee executed an agreement designating himself as a limited guarantor for the amount of $84,392.

On or about April 25, 2008, Appellee reaffirmed his guaranty of the first loan with a principal increase to $12.5 million and reaffirmed his limited guaranty of the second loan for $84,392. Thereafter, several circumstances arose which led to the default of payments on the loans for the "Water's Edge" project. As a result, SEPH's predecessor in interest filed suit against Water's Edge, LLC and a number of guarantors for the Water's Edge project, including Appellee. On November 14, 2017, the Baldwin County Circuit Court ruled in favor of SEPH on its claims against Appellee and other defendants. One month later, that court entered a judgment against Appellee in the amount of $9,168,468.14. Thereafter, SEPH discovered several transactions undertaken by Appellee, which it alleges violate the United States Bankruptcy Code. Those actions serve as the basis for this appeal.[1]

Following Appellant's filing of its adversarial complaint, the Bankruptcy Court conducted a hearing on Appellee's Motion for Judgment on the Pleadings. On January 5, 2018, the Bankruptcy Court entered an order in Appellee's favor. In its order, the Bankruptcy Court found that the provisions of the Bankruptcy Code upon which Appellant relied to except Appellee's debt from discharge were inappropriate, citing, *inter alia, BancorpSouth Bank v. Shahid,* No. 3:16cv621-RV/EMT (N.D. Fla 2017) for the proposition that Bankruptcy Code §523(a)(6) did not

[1] For a summary of the alleged fraudulent transfers and conveyances that serve as the underlying conduct of this action, *see* Doc. 6, pp. 15 – 23.

support excepting Appellee's debt from discharge because "the underlying debt is the result of personal guaranties, not any willful and malicious injury by Gaddy" (Doc. 6, p. 167), and Bankruptcy Code §523(a)(2)(A) could not support Appellant's cause of action because, *inter alia*, Appellee did not obtain the debt in controversy via actual fraud. (Doc. 6, p. 171).[2] SEPH appealed.

II. Standard of Review

Generally, district courts operate as appellate courts in bankruptcy matters. *In re Sublett*, 895 F. 2d 1381, 1383 – 1384 (11th Cir. 1990). As such, district courts will not make independent factual findings. Instead, district courts must affirm a bankruptcy court's factual findings unless the court applied an incorrect legal standard, applied the law in an unreasonable manner, followed improper procedures in making its determination, or made findings of fact that are clearly erroneous. *In re Horne*, 876 F. 3d 1076, 1083 (11th Cir. 2017); *Alabama Dept. of Human Resources v. Lewis*, 313 – 314 (Bkrtcy. S.D. Ala. 2002) (citing *In re Club Assoc.*, 956 F.2d 1065, 1069 (11th Cir. 1992)). *See also, In re International Pharm., & Discount II, Inc.*, 443 F.3d 767, 770 (11th Cir. 2005) ("[t]he bankruptcy court's findings of fact are not clearly erroneous, unless, in light of all of the evidence, we are left with the definite and firm conviction that a mistake has been made[]"); *In re Spiwak*, 285 B.R. 744, 747 (Bkrtcy. S.D. Fla. 2002) (providing that "[a] district court reviewing a

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[2] Section 523(a) provides, in relevant part, that:

> A discharge under [this chapter] 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 misrepresentation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> . . . (6) for willful and malicious injury by the debtor to another entity or to the property of another entity[.]

bankruptcy appeal is not authorized to make independent factual findings; that is the function of the bankruptcy court[]"); Fed.R.Bank.Proc. 8013 (on appeal, a bankruptcy court's findings of fact are reviewed for clear error).

District courts review a bankruptcy court's legal conclusions *de novo*; district court must accept bankruptcy court's factual findings unless they are clearly erroneous and give due regard to bankruptcy court's opportunity to judge credibility of witnesses. 28 USCS §158. *See also In re Simmons*, 200 F.3d 738, 741 (11th Cir. 2000); *In re Monetary Group*, 2 F.3d 1098, 1103 (11th Cir. 1993) (providing that legal determination are reviewed *de novo*). The reviewing court may affirm the bankruptcy court's decision on any basis supported by the record. *Big Top Koolers, Inc. v. Circus-Man Snacks, Inc.*, 528 F.3d 839, 844 (11th Cir. 2008).

III. Discussion

After full review, this court agrees with Judge Callaway for all the reasons articulated in his order. As Appellee has noted in his brief on appeal, the flaw in Appellant's position is the lack of an essential element in its requests for relief under §§523(a)(2)(A), and (a)(6). Specifically, Appellant's position is untenable as to the requirement that the "debt" be connected to the alleged improper conduct. (Appellee's Br. p. 7, 13).

As to §523(a)(2)(A), the debt Appellant seeks to discharge is for the pre-petition state court judgments rendered against Appellee based upon his promissory note guaranties. That debt was not "debt for money . . . to the extent obtained by . . . actual fraud" as required by the Bankruptcy Code. *See In re Wilson,* 2017 WL 1628878, at *8 (Bankr. N.D. Ohio 2017).[3] As noted

[3] Appellant cites, *inter alia, In re Smith*, to support its contention that fraudulent conveyances are due redress under §523(a)(2)(A) following the *Husky* decision. (Appellant's Br. p. 18). However, the Bankruptcy Court for the Northern District of Mississippi found that the debtor lied to a

by the bankruptcy court, the majority opinion in *Husky* did not go so far as to rule out the "[debt] obtained by . . . fraud" requirement. Instead, the Court only commented on the "[debt] obtained by . . . fraud" requirement in passing criticism of Justice Thomas's dissent.[4] This was only *dicta.* In this instance, Appellee undertook no fraudulent actions to acquire the debt it presently holds. Instead, the underlying debt appears to be the products of guaranties via contract. This court shall not go so far as to adopt an inapposite conclusion under the circumstances.

Nor was Appellee's debt a "debt for" willful and malicious injury by Appellant to another entity, or to the property of another entity as required by §523(a)(6). In this instance, Appellant did not conceal anything to incur the debt-at-issue. *See In re* Best, 109 Fed. App. 1, 5 (6th Cir.

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creditor to **actually induce** said creditor to make a loan for the debt at issue, holding consistent with the standard that a fraudulent statement must actually induce the debt at issue. As stated by that court:

> [T]he Debtor lied to Mr. Robinson to induce him to make the loan . . . The Debtor told Mr. Robinson that CGM presently needed $837,000 to pay Mr. Flautt. The evidence shows, however, that Mr. Flautt had already been paid when the loan was solicited by the Debtor. In addition, the Debtor told Mr. Robinson that CGM had a current receivable from PECO/Lansing for 200,000 bushels of corn, when, in fact, that receivable had already been paid. These two representations, from the Debtor to Mr. Robinson, were false at the time the Debtor made them. The Court further finds that the Debtor knew they were false at the time. The Debtor knew that Mr. Flautt had already been paid, because he was the one who paid him. Furthermore, as set forth above, the Court does not believe that the Debtor did not know that CGM had already received the payment from PECO/Lansing. Thus, the first and second elements are satisfied, to the extent of the $837,000 that the Debtor actually requested from Mr. Robinson.

585 B.R. 359, 368–69 (Bankr. N.D. Miss. 2018).

[4] *See Husky* at 1590 (2016) (reversing and remanding as to the meaning of "actual fraud").

2004). This court is satisfied that a debtor's actions after a debt has been incurred cannot support a claim under this provision, as the "injury is the underlying debt." *In re Kirwan*, No. 15-14012-MSH, 2016 WL 5110677, 4 (Bankr. D. Mass. 2016); *see also In re Saylor*, 108 F.3d 219, 221 (9th Cir. 1997) (creditor's potential fraudulent transfer remedies do not constitute "debt" or "property" under §523(a)(6)).

Accordingly, the decision and judgment rendered by the Bankruptcy Court on January 5, 2018, is hereby **AFFIRMED.**

DONE and **ordered** this 1st day of April, 2019.

/s/JEFFREY U. BEAVERSTOCK
UNITED STATES DISTRICT JUDGE

2020 WL 5793082
Only the Westlaw citation is currently available.
United States Court of Appeals, Eleventh Circuit.

IN RE: Jerry DeWayne GADDY, Debtor.
SE Property Holdings, LLC, Plaintiff - Appellant,
v.
Jerry DeWayne Gaddy, Defendant - Appellee.

No. 19-11699
|
(September 29, 2020)

Synopsis
Background: Creditor brought adversary proceeding against Chapter 7 debtor, seeking to determine nondischargeability of debt. The United States Bankruptcy Court for the Southern District of Alabama, No. 17-bkc-01568-HAC-7, granted debtor's motion for judgment on the pleadings and denied creditor leave to amend adversary complaint. The United States District Court for the Southern District of Alabama, No. 1:18-cv-00027-JB-N, affirmed. Creditor appealed.

Holdings: The Court of Appeals, Antoon, II, J., sitting by designation, held that:

[1] debt arising from state court judgment on breach of contract claim did not fall within fraud discharge exception;

[2] debtor's transfer of assets in an attempt to avoid collection of a preexisting debt for ordinary breach of contract claim did not render debt exempt from discharge under fraud discharge exception;

[3] debt did not fall within discharge exception for debts arising from willful and malicious injury; and

[4] Bankruptcy Court properly denied creditor leave to amend its adversary complaint.

Affirmed.

Procedural Posture(s): On Appeal; Motion for Judgment on the Pleadings.

West Headnotes (13)

[1] **Bankruptcy** Pleading; dismissal

Judgment on the pleadings is appropriate when material facts are not in dispute and judgment can be rendered by looking at the substance of the pleadings and any judicially noticed facts. Fed. R. Civ. P. 12(c); Fed. R. Bankr. P. 7012.

[2] **Bankruptcy** Conclusions of law; de novo review

Court of Appeals reviews legal determinations made by either the bankruptcy court or the district court de novo, and review the legal significance accorded to the facts de novo.

[3] **Bankruptcy** Presumptions and burdens of proof

In reviewing a ruling on a motion for judgment on the pleadings in bankruptcy proceeding, the Court of Appeals must accept all facts in the complaint as true and view those facts in the light most favorable to the plaintiff. Fed. R. Civ. P. 12(c); Fed. R. Bankr. P. 7012.

[4] **Bankruptcy** Debts and Liabilities Discharged

While the Bankruptcy Code protects creditors harmed by a debtor's egregious conduct, statutory exemptions to discharge of debts are construed strictly against the creditor and liberally in favor of the honest debtor. 11 U.S.C.A. § 523(a).

[5] **Bankruptcy** Discretion

Generally, the Court of Appeals reviews the denial of a motion for leave to amend a complaint in a bankruptcy proceeding for abuse of discretion. Fed. R. Civ. P. 15(a); Fed. R. Bankr. P. 7015.

[6] **Bankruptcy** Conclusions of law; de novo review

Where the lower court denies leave to amend adversary complaint based on futility of the proposed amendment, the Court of Appeals reviews that decision de novo because it is a conclusion that as a matter of law an amended complaint would necessarily fail. Fed. R. Civ. P. 15(a); Fed. R. Bankr. P. 7015.

[7] **Bankruptcy** Judgments

Debt arising from state court judgment on ordinary breach of contract claim, with no findings of fraud by the state court, did not fall within fraud discharge exception. 11 U.S.C.A. § 523(a)(2)(A).

[8] **Bankruptcy** Fraud

Chapter 7 debtor's transfer of assets in an attempt to avoid collection of a preexisting debt for ordinary breach of contract claim did not render that preexisting debt exempt from discharge under fraud discharge exception. 11 U.S.C.A. § 523(a)(2)(A).

[9] **Bankruptcy** Willfulness; willful injury

A debtor is responsible for a "willful" injury, within meaning of discharge exception for debts arising from willful and malicious injury, when he or she commits an intentional act the purpose of which is to cause injury or which is substantially certain to cause injury. 11 U.S.C.A. § 523(a)(6).

[10] **Bankruptcy** Malice; malicious injury

"Malicious," within meaning of discharge exception for debts arising from willful and malicious injury, means wrongful and without just cause or excessive even in the absence of personal hatred, spite or ill-will. 11 U.S.C.A. § 523(a)(6).

[11] **Bankruptcy** In general; fraud

Debt arising from state court judgment on ordinary breach of contract claim did not fall within discharge exception for debts arising from willful and malicious injury, regardless of debtor's actions after debt was incurred to thwart collection efforts. 11 U.S.C.A. § 523(a)(6).

[12] **Bankruptcy** Pleading

Bankruptcy Court properly denied creditor leave to amend its adversary complaint in nondischargeability proceeding to assert claim that Chapter 7 debtor's fraudulent transfer of assets to thwart creditor's collection of judgment debt created a new, separate debt under Alabama Uniform Fraudulent Transfer Act (AUFTA) that was exempt from discharge; such amendment would have been futile, since creditor was seeking a new judgment for the same debt, and asserted no independent, freestanding harm from the fraudulent transfers themselves other than its inability to collect the underlying debt. 11 U.S.C.A. §§ 523(a); Ala. Code § 8-9A-7(a); Fed. R. Civ. P. 15(a); Fed. R. Bankr. P. 7015.

[13] **Damages** Nature and theory of compensation

Generally, Alabama permits only one recovery for a given harm.

Attorneys and Law Firms

Richard M. Gaal, J. Alex Steadman, McDowell Knight Roedder & Sledge, LLC, Mobile, AL, for Plaintiff-Appellant.

Lee Rimes Benton, Douglas J. Centeno, Brenton Kirk Morris, Benton & Centeno, LLP, Birmingham, AL, for Defendant-Appellee.

Appeal from the United States District Court for the Southern District of Alabama, D.C. Docket No. 1:18-cv-00027-JB-N, Bkcy. No. 17-bkc-01568-HAC-7

Before WILLIAM PRYOR, Chief Judge, GRANT, Circuit Judge, and ANTOON, * District Judge.

Opinion

ANTOON, District Judge:

***1** A Chapter 7 bankruptcy is intended to give the debtor a fresh start, free from debt. The process usually entails liquidating the debtor's assets and applying the proceeds toward satisfaction of creditors' claims. If all goes well for the debtor, the court will, in the end, discharge the outstanding debts. But the Bankruptcy Code, in 11 U.S.C. § 523(a), exempts certain kinds of debts from discharge.

This is an appeal from an order rejecting a claim that a debt was not exempt from discharge under § 523(a). SE Property Holdings, LLC ("SEPH") brought an adversary proceeding in Jerry Gaddy's Chapter 7 bankruptcy. SEPH requested that the court declare Gaddy's debt to SEPH exempt from discharge under 11 U.S.C. § 523(a)(2)(A) and (a)(6) because Gaddy fraudulently conveyed his property, thwarting SEPH's efforts to collect the debt. But the bankruptcy court determined that Gaddy had not fraudulently obtained money or property as required for exemption from discharge under § 523(a)(2)(A) and that Gaddy had not injured SEPH within the meaning of § 523(a)(6). The court thus rejected SEPH's claims, granted Gaddy's motion for judgment on the pleadings, and dismissed the adversary proceeding. SEPH now appeals the district court's affirmance of the bankruptcy court's dismissal. We affirm.

I. BACKGROUND

Gaddy's debt to SEPH arose from two business loans made in 2006 by SEPH's predecessor-in-interest, Vision Bank, to Water's Edge LLC. The loans were made to fund a real estate development project in Baldwin County, Alabama. Gaddy, an investor in the project, personally guaranteed repayment of the entire first loan—$10 million—and $84,392.00 of the second loan. In 2008, he reaffirmed those guaranties and increased his obligation on the first guaranty to $12.5 million. About a year after the reaffirmances, several of the more than thirty guarantors began missing required capital contributions, and it became clear that the development project was in trouble. The missed payments prompted the bank to send a letter to the guarantors warning of potential default.

In October 2009, less than two weeks after the bank's warning, Gaddy conveyed parcels of real property to a newly formed LLC, of which the initial members were Gaddy, his wife, and his daughter; Gaddy later conveyed his own membership interest in the LLC to his wife and daughter. These were part of a series of conveyances of personal assets—including real property, cash, and business interests—that Gaddy made over the next five years to family members and entities that he controlled.

Water's Edge defaulted on both loans in 2010, and the bank demanded payment from Gaddy as a guarantor. Four months later, the bank sued Water's Edge, Gaddy, and other guarantors in an Alabama state court. Meanwhile, Gaddy continued to transfer his assets. In December 2014, SEPH, by then having been substituted for Vision Bank due to a merger, prevailed in the Water's Edge litigation. The state court entered a judgment in favor of SEPH and against Gaddy for more than $9.1 million. Gaddy made two more transfers of assets that same month.

***2** Eventually, SEPH sued Gaddy and his wife in federal court to set aside Gaddy's transfers of property under the Alabama Uniform Fraudulent Transfer Act ("AUFTA"). After SEPH amended its complaint to add Gaddy's daughter and several business entities as defendants in the AUFTA case, Gaddy filed for bankruptcy. This prompted SEPH to initiate the adversary proceeding in the bankruptcy court objecting to the discharge of its debt. In its complaint, SEPH described Gaddy's allegedly fraudulent transfers and asserted they had damaged SEPH by "depriv[ing SEPH] of assets of Jerry Gaddy that could be used to satisfy the judgment entered in the Water's Edge Litigation."

SEPH's complaint requested that the bankruptcy court declare its Water's Edge judgment against Gaddy exempt from discharge under 11 U.S.C. § 523(a)(2)(A) and (a)(6). In relevant part, these provisions state:

> (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 ...; [or]
>
> ....
>
> (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)(2)(A), (a)(6). SEPH urged the court to find that the debt was exempt from discharge under § 523(a)(2)(A) because Gaddy had fraudulently transferred assets to "hinder SEPH's collection." And SEPH claimed that the debt was exempt under § 523(a)(6) because through his transfers of assets, Gaddy had "willfully and maliciously injured" SEPH or its property.

A month after answering SEPH's complaint, Gaddy filed a motion for judgment on the pleadings.[1] Gaddy argued that SEPH's complaint failed to state a claim under either § 523(a)(2)(A) or § 523(a)(6) because he did not defraud SEPH in guarantying the loans and because his conveyances did not injure SEPH or its property. In its response to Gaddy's motion, SEPH argued not only that the Water's Edge judgment debt was exempt from discharge but also that "any fraudulent transfer judgment SEPH obtains against Gaddy would be" exempt if, as SEPH claims, those transfers were made "with a willful and malicious intent." And during oral argument on Gaddy's motion, SEPH requested leave to amend its complaint to add allegations that Gaddy's conveyances resulted in a separate debt to SEPH that was not exempt from discharge.

The bankruptcy court granted Gaddy's motion for judgment on the pleadings and dismissed the adversary proceeding. The court found that SEPH's § 523(a)(2)(A) claim failed because SEPH did "not contend that the underlying debt from the guaranties was obtained by fraud or was anything other than a standard contract debt." And the court similarly rejected SEPH's § 523(a)(6) argument because "[t]he underlying debt is the result of personal guaranties, not any willful and malicious injury by Gaddy." Finally, the court found no basis for amendment of SEPH's complaint to add a claim that a new, separate, fraudulent transfer debt under the AUFTA was exempt from discharge, noting that SEPH had "not provided any Alabama law that [a] debtor/transferor who fraudulently transfers property is liable to a creditor for the value of the transferred property."

SEPH appealed the bankruptcy court's decision, and the district court affirmed, "agree[ing] with [the bankruptcy judge] for all the reasons articulated in his order." It is from that decision that SEPH now appeals.

II. STANDARD OF REVIEW

*3 [1] [2] [3] [4] "Judgment on the pleadings is appropriate when material facts are not in dispute and judgment can be rendered by looking at the substance of the pleadings and any judicially noticed facts." *Bankers Ins. Co. v. Fla. Residential Prop. & Cas. Joint Underwriting Ass'n*, 137 F.3d 1293, 1295 (11th Cir. 1998). "We review legal determinations made by either the bankruptcy court or the district court *de novo*." *Crumpton v. Stephens (In re Northlake Foods, Inc.)*, 715 F.3d 1251, 1255 (11th Cir. 2013). We also "review the legal significance accorded to the facts *de novo*." *Id.* And in reviewing a ruling on a motion for judgment on the pleadings, "we must accept all facts in the complaint as true and view those facts in the light most favorable to the plaintiff." *Sun Life Assurance Co. of Canada v. Imperial Premium Fin., LLC*, 904 F.3d 1197, 1207 (11th Cir. 2018). While the Bankruptcy Code protects creditors harmed by a debtor's "egregious conduct," statutory exemptions to discharge of debts are construed strictly against the creditor and liberally in favor of the honest debtor. *St. Laurent v. Ambrose (In re St. Laurent)*, 991 F.2d 672, 680 (11th Cir. 1993) (quoting *In re Britton*, 950 F.2d 602, 606 (9th Cir. 1991)).

[5] [6] Generally, we review the denial of a motion for leave to amend a complaint for abuse of discretion. *Fla. Evergreen Foliage v. E.I. DuPont De Nemours & Co.*, 470 F.3d 1036, 1040 (11th Cir. 2006). But where the lower court denies leave to amend based on futility of the proposed amendment, we review that decision *de novo* because it is a "conclu[sion] that as a matter of law an amended complaint would necessarily fail." *Id.* (internal quotation marks

omitted) (quoting *Freeman v. First Union Nat'l*, 329 F.3d 1231, 1234 (11th Cir. 2003)).

III. DISCUSSION

On appeal, SEPH challenges the bankruptcy court's rulings that SEPH failed to state a claim that the Water's Edge judgment debt is exempt from discharge under § 523(a)(2)(A) or (a)(6). It also challenges the court's ruling that the AUFTA does not support a claim against Gaddy based on a "new" debt created by the fraudulent transfers themselves. We address these contentions in turn.

A. The Water's Edge Debt Is Not Exempt From Discharge Under 11 U.S.C. § 523(a)(2)(A)

Section 523(a)(2)(A) exempts from a debtor's discharge "any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent *obtained by* ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A) (emphasis added). That is, "it prevents discharge of 'any debt' respecting 'money, property, services, or ... credit' that the debtor has fraudulently obtained." *Cohen v. de la Cruz*, 523 U.S. 213, 218, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998) (alteration in original). The bankruptcy court and the district court both concluded that SEPH's § 523(a)(2)(A) claim failed because the loans that Gaddy guarantied were not "obtained by ... false pretenses, a false representation, or actual fraud." They were correct, and we reject SEPH's efforts to expand case law to encompass the circumstances presented by this case.

[7] SEPH does not—and cannot—argue that Gaddy or the entity whose debt he guarantied fraudulently obtained money or property from SEPH's predecessor. A state court awarded SEPH a judgment on its ordinary breach of contract claim, and that judgment makes no findings of fraud. The only fraud that SEPH alleges—Gaddy's conveyances of real and personal property—happened years after Gaddy incurred the debt by signing the guaranties. The money that the bank loaned is obviously not traceable to those later conveyances.

[8] SEPH nonetheless asserts that Gaddy's post-guaranty transfers of assets render the judgment debt exempt from discharge because Gaddy made those transfers to hinder its collection. In doing so, SEPH relies largely on a strained interpretation of, and dicta in, the Supreme Court's 2016 decision in *Husky International Electronics, Inc. v. Ritz*, —— U.S. ——, 136 S. Ct. 1581, 194 L.Ed.2d 655 (2016). But *Husky* does not advance SEPH's position.

***4** In *Husky*, the Supreme Court reviewed the ruling of the Court of Appeals for the Fifth Circuit that the "obtained by ... actual fraud" language in § 523(a)(2)(A) requires a fraud that "involves a false representation to a creditor," 136 S. Ct. at 1585, something not typically present in the fraudulent transfer context. Reversing the Fifth Circuit, the Supreme Court held that "[t]he term 'actual fraud' in § 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation." *Id.* at 1586. In doing so, the Court reached the same conclusion the Seventh Circuit had reached sixteen years earlier in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), the other case upon which SEPH heavily relies.

But the facts of *Husky* and *McClellan* are distinguishable, and their holdings are narrow. In both cases, someone other than the bankruptcy debtor initially owed a debt for which the bankruptcy debtor later became at least partially liable. In *Husky*, a corporation owed an ordinary debt to Husky. 136 S. Ct. at 1585. A corporate insider then became potentially personally liable to Husky under a Texas veil-piercing statute when he "drained [the corporation] of assets it could have used to pay its debts to creditors like Husky." *Id.* And in *McClellan*, the bankruptcy debtor's brother owed money on a loan. 217 F.3d at 892. The brother fraudulently transferred the creditor's security to his more-than-complicit sister, the debtor, who then became potentially liable to McClellan based on her role in the fraud. *See id.* at 892, 895. Because of the sister's fraud, depriving McClellan of his security interest, the sister's debt was exempt from discharge in her bankruptcy. *Id.* at 895.

Neither the Supreme Court nor the Seventh Circuit eliminated the requirement that for a debt to be exempt from discharge under § 523(a)(2)(A), the money or property

giving rise to the debt must have been "obtained by" fraud, actual or otherwise. Instead, these Courts merely recognized the possibility that fraudulent schemes lacking a misrepresentation—including fraudulent transfers of assets to avoid creditors—can satisfy the "obtained by" requirement in some circumstances. *See* 136 S. Ct. at 1589 (noting that "fraudulent conveyances are not wholly incompatible with the 'obtained by' requirement" of § 523(a)(2)(A), though "[s]uch circumstances may be rare"); *McClellan*, 217 F.3d at 895 (noting that although the debtor did not obtain the money by a fraud against her brother, she "would not have obtained a $160,000 windfall" but for fraud).[2]

SEPH seizes on this dictum and on the Supreme Court's comment that if a recipient of a fraudulent transfer "later files for bankruptcy, any debts 'traceable to' the fraudulent conveyance will be nondischarg[e]able under § 523(a)(2)(A)." *Husky*, 136 S. Ct. at 1589 (citation omitted). But these are not the facts of the case before us, and nothing in *Husky* suggests that a debtor's fraudulent transfer of assets renders an existing breach of contract judgment debt exempt from discharge under § 523(a)(2)(A). In both *Husky* and *McClellan*, fraudulent acts created or potentially created the very debts at issue. *See* *Husky*, 136 S. Ct. at 1585 (describing debtor's "drain[ing]" of corporate assets); *McClellan*, 217 F.3d at 895 ("The debt that McClellan is seeking to collect from [the bankruptcy debtor] (and prevent her from discharging) arises by operation of law *from her fraud*. That debt arose not when her brother borrowed money from McClellan but when she prevented McClellan from collecting from the brother the money the brother owed him." (emphasis in original)). Here, SEPH's assertions fail not because Gaddy did not engage in "actual fraud" by conveying his assets[3] but because the Water's Edge loans were not "obtained by" fraud as required for exemption under § 523(a)(2)(A).

***5** Again, the Water's Edge debt existed long before Gaddy began transferring his assets, and that debt is an ordinary contract debt that did not arise from fraud of any kind. SEPH presents no binding authority that supports its assertion that a debtor's fraudulent conveyance of assets in an attempt to avoid collection of a preexisting debt renders that preexisting debt exempt from discharge under § 523(a)(2)(A).

B. The Water's Edge Debt Is Not Exempt From Discharge Under 11 U.S.C. § 523(a)(6)

To qualify as exempt from discharge under § 523(a)(6), a debt must be a "debt ... for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6). SEPH claims that the Water's Edge debt is exempt under this provision because SEPH was injured by Gaddy's fraudulent conveyances of his personal assets—conveyances that SEPH asserts Gaddy made willfully and maliciously. We are not persuaded; SEPH has not alleged cognizable "injury" under § 523(a)(6).

[9] **[10]** "A debtor is responsible for a 'willful' injury when he or she commits an intentional act the purpose of which is to cause injury or which is substantially certain to cause injury." *Kane v. Stewart Tilghman Fox & Bianchi, P.A. (In re Kane)*, 755 F.3d 1285, 1293 (11th Cir. 2014) (quoting *Maxfield v. Jennings (In re Jennings)*, 670 F.3d 1329, 1334 (11th Cir. 2012)). And " '[m]alicious' means wrongful and without just cause or excessive even in the absence of personal hatred, spite or ill-will." *Id.* at 1294 (quoting *Maxfield*, 670 F.3d at 1334).

[11] In focusing on the nature of Gaddy's conduct, SEPH skips an important step in its § 523(a)(6) analysis. To be exempted from discharge under this provision, an obligation must be a "debt ... *for* willful and malicious injury." 11 U.S.C. § 523(a)(6) (emphasis added). As the Supreme Court has explained, " 'debt for' is used throughout [§ 523(a)] to mean 'debt as a result of,' 'debt with respect to,' 'debt by reason of,' and the like." *Cohen*, 523 U.S. at 220, 118 S.Ct. 1212 (citing *American Heritage Dictionary* 709 (3d ed. 1992) and *Black's Law Dictionary* 644 (6th ed. 1990)). In this case, the Water's Edge debt is a contract debt that was incurred long before the challenged conveyances. SEPH's complaint in the adversary proceeding did not allege that the Water's Edge debt was the "result of," "with respect to," or "by reason of" Gaddy's tortious conduct. The only misconduct alleged by SEPH pertains to Gaddy's fraudulent conveyances of assets. But those conveyances occurred years after Gaddy became indebted to SEPH for the Water's Edge guaranties, and the

conveyances are not traceable to that debt, which arose from an ordinary breach of contract.

SEPH argues that it should prevail under *Maxfield*, in which this Court affirmed a ruling that a fraudulent transfer judgment was exempt from discharge under § 523(a)(6). But as the bankruptcy court correctly concluded, *Maxfield* is distinguishable because the debt at issue there—the debtor's joint and several liability for part of her ex-husband's preexisting debt—arose from the debtor's participation as a conspirator in the fraudulent transfer of property; it thus was "for willful and malicious injury" and qualified for exemption under § 523(a)(6). *Maxfield*, 670 F.3d at 1331–34. In contrast, the Water's Edge debt arose from breach of guaranty, not from a "willful and malicious injury."

We are not persuaded by SEPH's argument that actions taken by a debtor after a debt is incurred, even if in an effort to thwart a creditor's collection efforts by fraudulently conveying assets, create a separate injury for the purposes of § 523(a)(6). The Water's Edge debt—incurred long before Gaddy's conveyances of assets—was not "for willful and malicious injury" to SEPH or its property, and SEPH's § 523(a)(6) claim that its Water's Edge judgment is exempt from discharge fails as a matter of law.

C. The Bankruptcy Court Correctly Denied Leave to Amend Because of the Futility of SEPH's Proposed Amendment Under the AUFTA

***6** **[12]** We now turn to the issue that SEPH belatedly raised in the bankruptcy court. SEPH contends that Gaddy's fraudulent transfers of assets gave rise to a new debt to SEPH under the AUFTA—separate from the Water's Edge judgment—that qualifies as exempt from discharge under both § 523(a)(2)(A) and § 523(a)(6). Although SEPH did not rely on this theory in its adversary complaint, during oral argument in the bankruptcy court SEPH requested leave to amend to specifically add it as a basis for relief. Under this alternative approach, SEPH argues that the transfers resulted in Gaddy becoming indebted to SEPH for an amount equal to the value of the assets conveyed. These debts, SEPH maintains, arise from "actual fraud" under § 523(a)(2)(A) and were "for willful and malicious injury" within the meaning of § 523(a)(6). The bankruptcy court rejected the proposed amendment on the view that Alabama law would not permit recovery against a fraudulent transferor. We also reject the proposed amendment, though for a different reason. We conclude that Alabama law would not permit the double recovery SEPH seeks.

There can be no issue as to dischargeability unless a debt or potential debt exists. Although there is no dispute that Gaddy owes the Water's Edge debt—which, as discussed earlier, did not arise from fraud or willful and malicious injury—SEPH has not established a basis for a "fraudulent transfer debt" owed or potentially owed by Gaddy to SEPH.

The AUFTA specifies the remedies available to creditors when a debtor fraudulently transfers property:

> (a) In an action for relief against a transfer under this chapter, the remedies available to creditors ... include:
>
> (1) Avoidance of the transfer to the extent necessary to satisfy the creditor's claim;
>
> (2) An attachment or other provisional remedy against the asset transferred or other property of the transferee in accordance with the procedure prescribed by any applicable provision of any other statute or the Alabama Rules of Civil Procedure;
>
> (3) Subject to applicable principles of equity and in accordance with applicable rules of civil procedure,
>
> a. An injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;
>
> b. Appointment of a receiver to take charge of the asset transferred or of other property of the transferee; or
>
> c. Any other relief the circumstances may require.

Ala. Code § 8-9A-7(a). SEPH relies on the "[a]ny other relief the circumstances may require" language of § 8-9A-7(a)(3)(c) to argue that it is entitled to a money judgment against Gaddy in the amount of the fraudulent transfers, and it relies on 11 U.S.C. § 523(a)(2)(A) and § 523(a)(6) to argue that this judgment is exempt from discharge.

[13] Generally, Alabama permits only one recovery for a given harm. *Braswell v. ConAgra, Inc.*, 936 F.2d 1169,

1173–74 (11th Cir. 1991); *see also* *Steger v. Everett Bus Sales*, 495 So. 2d 608, 609 (Ala. 1986). Yet SEPH seeks a new judgment for the same debt. It already has a judgment against Gaddy for the unpaid Water's Edge guaranties. It now seeks a second judgment entitling it to the same damages. SEPH asserted below no independent, freestanding harm from the fraudulent transfers themselves; it complained only that the transfers kept it from collecting the underlying debt.

Attempting to support its double-recovery theory, SEPH directs our attention to *Johns v. A.T. Stephens Enterprises, Inc.*, 815 So. 2d 511 (Ala. 2001). There, the Supreme Court of Alabama affirmed a jury's award of compensatory damages under § 8-9A-7(a)(3)(c) on a conspiracy-to-defraud claim. *Id.* at 516–17. But *Johns* is not helpful to SEPH's argument. That case involved the plaintiff's lease of trucks to a corporate defendant. The jury awarded compensatory damages on plaintiff's conspiracy claim against that defendant and conspiring codefendants for the plaintiff's lost profits—a harm separate from the underlying debt. *Id.*; *see also* *A.T. Stephens Enters., Inc. v. Johns*, 757 So. 2d 416 (Ala. 2000) (prior appeal providing background facts). Here, by contrast, SEPH asserts no harm from the fraudulent transfers other than its inability to collect the underlying debt. *Johns* offers no support for that theory of recovery because it does not change the principle that "Alabama law bars double recovery of compensatory damages for a fraud claim and a contract claim based on a single transaction." *Braswell*, 936 F.2d at 1173.

*7 SEPH now also asserts that it could potentially recover punitive damages, attorney's fees, lost profits, or consequential damages on its fraudulent transfer claims against Gaddy. However, not only are these claims vague, but also SEPH did not raise these points before the bankruptcy court. We therefore decline to address them. *See* *JWL Entm't Grp., Inc. v. Solby+Westbrae Partners (In re Fisher Island Invs., Inc.)*, 778 F.3d 1172, 1193–94 (11th Cir. 2015).

For these reasons, we conclude that the bankruptcy court correctly determined that SEPH was not entitled to leave to amend its adversary complaint because such amendment would have been futile.

IV. CONCLUSION

Accordingly, we affirm the judgment of the district court.

All Citations

--- F.3d ----, 2020 WL 5793082

Footnotes

* Honorable John Antoon II, United States District Judge for the Middle District of Florida, sitting by designation.

1 Federal Rule of Civil Procedure 12(c) provides: "After the pleadings are closed—but early enough not to delay trial—a party may move for judgment on the pleadings." Federal Rule of Bankruptcy Procedure 7012(b) incorporates Rule 12(c) in adversary proceedings.

2 As to whether the "obtained by" requirement was satisfied under the facts of *Husky*, the Supreme Court remanded to the circuit court. 136 S. Ct. at 1589 n.3.

3 We make no findings on whether Gaddy's transfers were indeed fraudulent. We accept the allegations of SEPH's complaint as true in reviewing a ruling on a motion for judgment on the pleadings. *See* *Sun Life Assurance*, 904 F.3d at 1207.

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