

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

ENTERED

NOV 28 2003

U.S. BANKRUPTCY COURT
MDNC - BRW

IN RE:)
)
Magna Corporation,) Case No. 01-80763 C-7D
)
)
Debtor.)
_____)
)
William L. Yaeger, Trustee)
in Bankruptcy for Magna)
Corporation,)
)
Plaintiff,)
)
v.) Adversary No. 03-9032
)
)
Magna Corporation, Steven E.)
Edwards, Marian Carol Edwards,)
Carolina Green, Inc.,)
Capital Financial Group,)
Inc., d/b/a Capital Marketing,)
Inc., The Nations Group, Inc.,)
and 2VC Holdings, Ltd.)
)
Defendants.)

ORDER

This adversary proceeding came before the court on September 25, 2003, for hearing upon a motion by defendant Marian Carol Edwards to dismiss and a motion to strike contained in her answer to the Plaintiff's amended complaint. Jean Winborne Boyles and F. Stephen Glass appeared on behalf of Marian Carol Edwards and Sara A. Conti appeared on behalf of the Plaintiff.

The Plaintiff in this adversary proceeding is William L. Yaeger as Chapter 7 Trustee for Magna Corporation, the Debtor in the underlying Chapter 7 case. The amended complaint contains

seven counts and names as defendants various corporations as well as Steven E. Edwards and Marian Carol Edwards as individual defendants. Marian Carol Edwards is named as a defendant in four of the counts, those counts being Count II which is designated as a claim for fraudulent conveyance, Count V which is designated as a claim for conversion, Count VI which also is designated as a claim for conversion and Count VII which is designated as a claim for breach of corporate duty. The answer to the amended complaint that was filed on behalf of Marian Carol Edwards contains a motion pursuant to Rules 12(b) (6) to dismiss the amended complaint in its entirety for failure to state a claim upon which relief can be granted and as time barred and an alternative motion to strike pursuant to Rule 12(f). The answer filed on behalf of Marian Carol Edwards ("Movant") also asserts that the counts alleging fraudulent conveyances fail to state with particularity all of the averments of fraud as required by Rule 9(b).

- A. The motion to dismiss for failure to state a claim for relief

Pursuant to Rule 7012(b) of the Federal Rules of Bankruptcy Procedure, Rule 12(b)-(h) of the Federal Rules of Civil Procedure applies in adversary proceedings in the Bankruptcy Court. Under Rule 12(b) (6) a defendant may move to dismiss for failure to state a claim upon which relief can be granted. Under Rule 12(b) (6) the party moving for dismissal has the burden of proving that no claim has been stated and in order to prevail must show "'beyond doubt

that the plaintiff can prove no set of facts in support of his claim [that] would entitle him to relief." ' See 2 MOORE'S FEDERAL PRACTICE § 12.34[1] [a] (3d ed. 2003), citing Connally v. Gibson, 355 U.S. 41, 45-46, 78 S.Ct. 99, 102, 2 L.Ed.2d 80 (1957). During the threshold review under Rule 12(b)(6), the issue is not whether a plaintiff will ultimately prevail but whether the plaintiff is entitled to offer evidence to support the claims. Id. In ruling on a Rule 12(b) (6) motion, the court must accept the plaintiff's factual allegations as true and give the plaintiff the benefit of all reasonable inferences to be drawn from such factual allegations. See Ibarra v. United States, 120 F.3d 472, 474 (4th Cir. 1997). A court ruling on a motion pursuant to Rule 12(b) (6) should construe the plaintiff's allegations liberally because the rules require only general or notice pleading, rather than detailed fact pleadings. See 2 MOORE'S FEDERAL PRACTICE § 12.34[1] [b] (3d ed. 2003). Consistent with the obligation to construe plaintiff's allegations liberally, courts should not dismiss for failure to state a claim merely because the complaint requests inappropriate relief or because it miscategorizes legal theories. Id. However, liberal construction has **its limits** and conclusory allegations or merely legal conclusions will not suffice to prevent a motion to dismiss. Id. Applying the foregoing standards in the present case, the court concludes that the Counts II, V, VI and VII of the amended complaint are sufficient to state **claims** against the Movant

upon which relief could be granted.

Taken in the light most favorable to the Plaintiff, the allegations contained in Count II allege that funds of the Debtor were transferred to or for the benefit of the Movant at a time when the Debtor was insolvent or thereby rendered insolvent and without the Debtor receiving any consideration for such transfers. The allegations in Count II specify that the amounts involved were \$104,018.19, \$4,284,011.43 and \$166,663.73 which the amended complaint alleges were transferred to or for the benefit of the Movant and her husband. Taken in the light most favorable to the Plaintiff and giving the Plaintiff the benefit of the reasonable inferences to be drawn from the allegations in the amended complaint, the allegations in Count II are sufficient to allege a claim against the Movant for fraudulent conveyance under § 544 and the North Carolina Uniform Fraudulent Transfer Act, N.C.G.S. § 39-23.1, et. seq., and § 550, as well as a claim under § 548(a) (1) (A) and (B) as to the transfers which occurred within one year prior to the Debtor's bankruptcy filing.

Counts V and VI are designated as claims for conversion against the Movant and her husband. Both counts allege that Movant and her husband converted funds of the Debtor by causing funds belonging to the Debtor, represented by checks payable to the Debtor or to Capital Marketing, Inc., a division or subsidiary of the Debtor, to be transferred to or for the benefit of the Movant

and her husband by depositing such funds into Movant's personal bank account, by using the funds to purchase personal assets of the Movant or by depositing the funds into the accounts of corporations controlled by the Movant and her husband. The allegations which are set forth in Counts V and VI, together with the allegations that are incorporated into Counts V and VI, allege that the Movant and her husband opened and controlled savings and checking accounts in the name of Capital Marketing, Inc., that they exercised complete control over the accounts, including the withdrawal of funds from the accounts, that they caused funds of the Debtor or its subsidiary to be deposited into the accounts without the Debtor receiving any consideration for such transfers, and that they then caused such corporate funds to be withdrawn from the accounts and transferred directly to or for the benefit of Movant and her husband or indirectly to them by deposit into the account of a corporation controlled by them. Conversion is an unauthorized assumption and exercise of the right of ownership over the property of another or the unauthorized exclusion of the owner's rights to his or her property. See Spinks v. Taylor, 303 N.C. 256, 264, 278 S.E.2d 501, 506 (1981). Construed liberally and taken as true, the allegations contained in Counts V and VI allege an unauthorized exercise of control and wrongful taking for their use and benefit by Movant and her husband with respect to funds of the Debtor and hence are sufficient to state a claim for conversion. Movant's

assertion that because Plaintiff was not a shareholder of Capital Marketing, Inc., the Plaintiff may not also rely upon piercing the corporation veil of Capital Marketing, Inc. as an alternative basis for asserting liability against the Movant is not accepted. The amended complaint alleges that the Movant was a director and hence a part of the management of Capital. As pointed out in ROBINSON ON NORTH CAROLINA CORPORATION LAW, § 2.01[2] the "owners and management" of a corporation may have personal liability if they do not recognize and treat the corporation as a separate entity. One of the allegations in the amended complaint is that the Movant and her husband exercised such domination and control over the operation of Capital that there was no separate corporate existence and that "[a]fter the initial corporate resolutions were executed, no corporate formalities were observed, no corporate records were kept, no officers or directors other than Edwards and Carol Edwards functioned in any way, no dividends were paid, and funds were commingled among several corporate entities and the individuals themselves." The facts alleged by Plaintiff regarding Movant's relationship with Capital are sufficient to support Plaintiff's alternative theory of disregarding the corporate form of Capital and treating the deposit of the funds into Capital's accounts as being receipt of the funds by the Movant and her husband.

Count VII seeks to allege a claim against Movant for breach of the Movant's duty as a director of the Debtor, a Kansas

corporation. The claim is based upon a Kansas statute that imposes a duty of loyalty upon corporate directors and forbids acts or omissions by directors which are not in good faith or which involve intentional misconduct and also forbids participation by a director in any transaction from which the director derives a personal benefit. The allegations of fraudulent conveyances to Movant and conversion of corporate funds by Movant which are incorporated into Count VII of the complaint are sufficient to allege a claim against Movant for breach of duty on the part of Movant as a director of the Debtor.

B. The motion to dismiss based upon the statute of limitations

Dismissal under Rule 12(b)(6) may be appropriate when a successful affirmative defense or other bar to relief appears on the face of the complaint, such as the statute of limitations. See Chapelle v. Berkshire Life Ins. Co., 142 F.3d 507, 509 (1st Cir. 1998); La Porte Constr. Co. v. Bavshore Nat'l Bank, 805 F.2d 1254, 1255 (5th Cir. 1986). In the present case, the Movant argues that the claims alleged in the amended complaint should be dismissed as being time barred. The statute of limitation relied upon by the Movant in asserting that the claims against her are time barred is contained in § 546(a) of the Bankruptcy Code which provides:

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of-

(1) the later of-

- (A) 2 years after the entry of the order for relief; or
- (B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or

(2) the time the case is closed or dismissed.

Based upon the Debtor's Chapter 7 having been filed on March 19, 2001, the Movant contends that the statute of limitations under § 546 expired in the present case on March 19, 2003. Although Plaintiff's original complaint was filed prior to that date, the amended complaint was not filed until August 18, 2003, which is more than two years after the filing of the Chapter 7 case. The Movant argues that the relation back provisions of Rule 15¹ are not applicable in this case and that the claims alleged in the amended complaint therefore are barred pursuant to § 526(a).

The threshold question in dealing with Movant's statute of limitations motion is whether the amended complaint relates back to the filing of the original complaint which, in turn, depends upon whether the claims asserted in the amended complaint arose out of the conduct, transaction or occurrence set forth or attempted to be

¹Rule 15(c) of the Federal Rules of Civil Procedure provides in pertinent part that "[a]n amendment of a pleading relates back to the date of the original pleading when . . . the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading"

set forth in the original complaint. In applying this provision of Rule 15(c), the court must focus upon two issues. First, to relate back there must be a factual nexus between the two complaints. Second, if there is some factual nexus an amended claim is liberally construed to relate back to the original complaint if the defendant had notice of the claim and will not be prejudiced by the amendment. See Gratten v. Burnett, 710 F.2d 160, 163 (4th Cir. 1983), aff'd 468 U.S. 42, 104 S.Ct. 2924, 82 L.Ed.2d 36 (1984). However, if a plaintiff is trying to "interject entirely different conduct or different transactions or occurrences into a case, then relation back is not allowed." See F.D.I.C. v. Conner, 20 F.3d 1376, 1385 (5th Cir. 1994). In determining whether there is a factual nexus between an original complaint and an amended complaint, the court must compare the allegations contained in the original complaint with the allegations contained in the amended complaint to see whether the allegations in the amended complaint involve the same transaction, occurrence or core of operative facts involved in the original complaint. See Percy v. San Francisco Gen. Hosp., 841 F.2d 975, 978 (2d Cir. 1988).

In the motion to dismiss, the Movant argues that the original complaint was limited to specific or specified transfers of funds into the Capital bank accounts and that the amended complaint has added new, unconnected transfers. A comparison of the two complaints, however, disproves this allegation. Count I of the

original complaint alleges that "large sums of money, in the amount of at least \$94,894.78" from the Debtor were deposited into bank accounts of either Capital Financial Group, Inc. or Capital Marketing, Inc. Rather than being limited to a specified amount or specified deposits, this allegation is open ended and broad enough to include additional transfers than those which would total only \$94,984.78. In the original motion to dismiss, one of the points raised by the Movant was the failure to be specific regarding the transfers involved in the fraudulent conveyance claim alleged in Count I of the original complaint. In response to Movant's objection to the general, open ended allegation in the original complaint, the amended complaint specifies the amounts and dates of deposit of funds of the Debtor which were deposited into the Capital bank accounts and which are alleged to be fraudulent conveyances, and also includes by date and amount transfers to the Movant and her husband which the Plaintiff seeks to recover. The transaction or occurrence involved in Count I of the original complaint was the deposit of large sums of money from the Debtor into the Capital bank accounts which occurred without the Debtor receiving any consideration and which ultimately were received by the Movant and her husband. There is a definite factual nexus between those allegations and the allegations in Count II of the amended complaint in which the Plaintiff was more specific regarding the dates and amounts of the transfers which are alleged

to have been fraudulent conveyances, as well as the dates and amounts of the transfers from the Capital Account to or for the benefit of the Movant. There likewise is a factual nexus between the conversion **claim** in the original complaint and the conversion **claims** alleged in Counts V and VI of the amended complaint. In the original complaint, the conversion **claim** incorporated the earlier allegations in the complaint regarding the transfers that were alleged to be part of the fraudulent conveyance claim. In the conversion claims in the amended complaint, the earlier transfers or deposits that are alleged in the fraudulent conveyance **claims** are incorporated into the conversion claims. Since there is a factual nexus between allegations in the fraudulent conveyance **claims** in the two complaints, it follows that such factual nexus carried over to the conversion **claims** when the fraudulent conveyance allegations were incorporated into the conversion **claims**. The conversion claim in Count VI of the amended complaint also includes an allegation that the Movant converted an additional \$275,000.00 that was deposited into the 2VC offshore account. There is a factual nexus between the 2VC allegations in the two complaints because the original complaint likewise alleges that the Movant converted the \$275,000.00 that was deposited into the 2VC account. Finally, there is a factual nexus between the breach of corporate duty claim in the original complaint and the breach of corporate duty in the amended complaint since the breach of

corporate duty claim in the amended complaint incorporates the previous allegations of conversion and receipt by the Movant of funds of the Debtor pursuant to fraudulent conveyances to or for the benefit of Movant. Under Rule 15 (c), the critical issue is whether the claim stated in the amended complaint arises out of the conduct, transaction or occurrence set forth in the original complaint, and not whether the claim alleged in the amended complaint is based upon a different theory or constitutes a new claim. See 3 MOORE'S FEDERAL PRACTICE § 15.19[2] (3d ed. 2003). Thus, relation back is permitted when the new claim is based upon the same core facts as the original complaint even though the amended complaint changes the legal theory relied upon by the plaintiff. See Koal Indus. Corp. v. Asland, S.A., 808 F.Supp. 1143, 1158 (S.D.N.Y. 1992) (an occurrence or transaction may give rise to many claims and an amendment that only changes the legal theory or adds another claim arising from the occurrence or transaction relates back). See also Donnelly v. Yellow Freight Sys., Inc., 874 F.2d 402, 410 (7th Cir. 1989). Likewise, where, as in the present case, there is a factual nexus, the fact that the original complaint was deficient and did not adequately state the claim sought to be alleged does not prevent relation back when an amended complaint is filed in order to adequately plead the cause of action. See McClellon v. Lone Star Gas Co., 66 F.3d 98, 102-03 (5th Cir. 1985); United States ex rel. Canion v. Randall &

Blake, 817 F.2d 1188, 1191 (5th Cir. 1987). Relation back also applies under Rule 15(c) with respect to amendments that amplify or restate the original pleading or set forth facts with greater specificity. McClellon, 66 F.3d at 102-03. Thus, relation back to the original complaint is not precluded in the present case merely because the amended complaint cited the wrong statute in the breach of corporate duty claim and the amended complaint corrected the statutory reference or because the amended complaint amplified the allegations in order to correct deficiencies in some of the claims which the Plaintiff sought to include in the original complaint. The critical factors are that all of the claims in the amended complaint arose out of the occurrences and transactions alleged in the original complaint and the allegations in the original complaint were broad enough to provide the Movant with notice of all of the claims that are included in the amended complaint such that the Movant is not prejudiced by the amendment. It follows that the amended complaint relates back to the date of the filing of the original complaint pursuant to Rule 15(c) and that the claims alleged against the Movant in the amended complaint therefore are not barred by the two-year statute of limitation contained in § 546(a) (1) (A) of the Bankruptcy Code.

The court also has considered Movant's motion to strike pursuant to Rule 12(f) and the portion of the motion based upon Rule 9(b). Under Rule 12(f) the court may strike any "redundant,

immaterial, impertinent or scandalous matter." Movant has failed to identify any portions of the amended complaint which should be stricken pursuant to Rule 12(f). Rule 9(b) requires that "[i]n all averments of fraud . the circumstances constituting fraud. . shall be stated with particularity." The amplified allegations contained in the fraudulent conveyance counts which include dates and amounts of deposits alleged to be transfers of property of the Debtor, together with amounts and dates of transfers to or for the benefit of the Movant from accounts that received deposits of Debtor's funds, satisfy the particularity requirement of Rule 9(b). Moreover, where the plaintiff is a trustee acting on behalf of a bankruptcy estate, Rule 9(b) should be applied with greater flexibility since the trustee must rely upon second-hand knowledge of pre-petition fraudulent acts involving the debtor and third parties. See In re Perez, 155 B.R. 844, 849 (Bankr. E.D.N.Y. 1993). Accordingly, Movant is entitled to no relief under Rule 12(f) or Rule 9(b).

Now, therefore, it is ORDERED that the motions to dismiss and strike filed on behalf of defendant Marian Carol Edwards shall be and hereby are overruled and denied.

This 28th day of November, 2003.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge