THIS ORDER IS SIGNED AND ENTERED.

Dated: July 25, 2024

Rachel Blise

Hon. Rachel M. Blise
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

In re:

Andrew M. Johnson,

Debtor.

Case No. 23-11365-rmb

Chapter 7

Diana Cannon

Plaintiff,

v.

Andrew M. Johnson

Defendant.

Adversary No. 23-00041-rmb

DECISION AND ORDER GRANTING IN PART AND DENYING IN PART DEFENDANT'S MOTION TO DISMISS

Plaintiff Diana Cannon filed an eight-count Amended Complaint against debtor Andrew Johnson. ECF No. 11 ("Am. Compl."). Cannon asks the Court to declare a debt nondischargeable under 11 U.S.C. § 523(a)(2)(A), (a)(4), (a)(6), and (a)(19). She also includes three state-law causes of action for intentional misrepresentation, breach of fiduciary duty, and Wisconsin securities fraud under § 551.501(2). Johnson filed a motion to dismiss the Amended Complaint, arguing that it does not state a claim. For the reasons explained below, the Court grants the motion to dismiss with respect to Count 3 (breach of fiduciary duty) and Count 5

(nondischargeability under § 523(a)(4)), and the Court denies the motion with respect to the remaining claims.

JURISDICTION

The Court has jurisdiction over the motion to dismiss pursuant to 28 U.S.C. § 1334 and the order of reference from the district court pursuant to 28 U.S.C. § 157(a). *See* General Order No. 161 (W.D. Wis. June 12, 1984) (available at https://www.wiwd.uscourts.gov/administrative-orders) (last visited July 25, 2024). Determination of the dischargeability of a debt is a core proceeding under 28 U.S.C. § 157(b)(2)(I). To the extent the determination of dischargeability requires consideration of issues impacted by the Supreme Court's decision in *Stern v. Marshall*, 564 U.S. 462 (2011), Cannon expressly consented to adjudication of such issues by this Court. Am. Compl. ¶ 6. Johnson did not expressly consent, but he has consented by his silence on the matter in his motion to dismiss. *See* Fed. R. Bankr. P. 7008, 7012(b); *see also Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665, 683 (2015) ("Nothing in the Constitution requires that consent to adjudication by a bankruptcy court be express.").

FACTS ALLEGED IN AMENDED COMPLAINT

For purposes of deciding the motion to dismiss, the Court accepts as true the following facts alleged in the Amended Complaint. Johnson owned and operated a Wisconsin corporation by the name of Ocooch Mountain Management Co. Am. Compl. ¶¶ 7-8. In early 2020, Johnson sought investors for Ocooch to fund the development of a restaurant and a bed and breakfast in Kendall, Wisconsin. *Id*. ¶ 10. At the time, Johnson was working as a liaison for Bio-Sunn Technologies, Inc., and Johnson believed that Bio-Sunn's planned development of a processing plant in Kendall would bring additional business opportunities to the area. *Id*. ¶¶ 11-12.

In February 2020, Johnson asked Cannon to lend Ocooch $26,000 and offered her a promissory note in exchange for the loan. *Id*. ¶¶ 19, 21. Johnson represented that the money

would be used to prepare the restaurant and bed and breakfast to open for business. *Id*. ¶ 20. Johnson did not tell Cannon that any of the funds would be used to pay Johnson himself or his receptionist. Cannon relied on Johnson's representation, and omission, in making her investment. *Id*. ¶¶ 22, 40.

Ocooch borrowed a total of $36,000 from Cannon and her brother-in-law. *Id.* ¶ 36. Ocooch gave Cannon a promissory note for $26,000 with a term of three years at 20% interest to be paid in monthly installments. *Id*. ¶ 27 & Ex. A. Over the next few months, Cannon received four checks for monthly payments due under the note; one of the checks was returned for insufficient funds and all the payments were late. *Id.* ¶¶ 29-34.

Before Cannon and her brother-in-law lent funds to Ocooch, the balance in its bank account was $200. *Id.* ¶ 36. Cannon alleges that $12,814.12 of the borrowed money was paid directly to Johnson and his receptionist. *Id*. ¶ 38. The rest of the funds are unaccounted for, and by March 31, 2020, the company's bank account had a negative balance. *Id*. ¶¶ 37-38. Cannon made several requests for an accounting of the funds that Johnson never answered. *Id*. ¶¶ 31, 33.

In 2022, the Wisconsin Department of Financial Institutions Division of Securities (DFI) opened an investigation into Johnson's business affairs. *Id.* ¶ 41. On August 16, 2022, DFI issued a Final Order by Consent to Cease and Desist (the "Consent Order"). *Id.* ¶ 42 & Ex. B. DFI concluded that the promissory note from Ocooch to Cannon was a security under Wis. Stat. § 551.102(28)(d)(1), and that Johnson violated Wis. Stat. § 551.501(2) by omitting material facts in connection with the promissory note. *Id.* ¶ 43 & Ex. B at 4-5, ¶¶ 33-34. Johnson signed a Waiver and Consent to Order on behalf of himself and Ocooch, in which he waived his right to a hearing on the matter and agreed to issuance of the Consent Order. Am. Compl. ¶ 44 & Ex B. The Consent Order prohibits Johnson from selling securities in Wisconsin, but DFI did not make

any findings as to the amount, if any, of Cannon's damages and it did not award her any damages. *Id.*

Cannon filed an action in Wisconsin state court in early 2023 alleging misrepresentation, breach of contract, and securities fraud under Wis. Stat. § 551.501(2). Am. Compl. ¶ 51. Johnson filed a voluntary chapter 7 petition on August 7, 2023, which stayed the state court lawsuit before any decision on the merits of Cannon's claims. *Id*. ¶ 52. Cannon now seeks to have the debt owed to her declared not dischargeable.

DISCUSSION

Applicable Pleading Standard

Johnson moves to dismiss under Federal Rule of Civil Procedure 12(b)(6), made applicable to this adversary proceeding by Federal Rule of Bankruptcy Procedure 7012. The purpose of a Rule 12(b)(6) motion to dismiss is to test the sufficiency of the complaint, not to decide the merits of the case. *Gibson v. City of Chicago*, 910 F.2d 1510, 1520 (7th Cir. 1990). In reviewing a motion to dismiss under Rule 12(b)(6), the Court takes as true all well-pleaded factual allegations in the plaintiff's complaint and draws all reasonable inferences in the plaintiff's favor. *Id*. at 1520-21. Exhibits attached to the complaint are also considered as part of the pleadings. *Bogie v. Rosenberg*, 705 F.3d 603, 609 (7th Cir. 2013).

To survive a Rule 12(b)(6) motion, the Amended Complaint must meet the pleading standard under Federal Rule of Civil Procedure 8, made applicable to this proceeding by Federal Rule of Bankruptcy Procedure 7008. Rule 8 requires a complaint contain "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). The factual allegations "must be enough to raise a right to relief above the speculative level," meaning that they are more than "merely consistent with" the defendant's liability.

Twombly, 550 U.S. at 555-57. Exactly how specific a complaint must be varies with the complexity of a plaintiff's claim, but "the plaintiff must give enough details about the subject-matter of the case to present a story that holds together." *Swanson v. Citibank, N.A.*, 614 F.3d 400, 404 (7th Cir. 2010). "In other words, the court will ask itself *could* these things have happened, not *did* they happen." *Id*. (emphases in original).

To the extent the Amended Complaint alleges fraud, the facts alleged must meet the heightened pleading standard of Federal Rule of Civil Procedure 9(b), made applicable to this proceeding by Federal Rule of Bankruptcy Procedure 7009. Rule 9(b) provides: "In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Fed. R. Civ. P. 9(b). That is, the plaintiff must allege the "'who, what, when, and where' of the alleged fraud." *Uni*Quality, Inc. v. Infotronx, Inc.*, 974 F.2d 918, 923 (7th Cir. 1992).

State-Law Claims – Counts 1, 2, and 3

The first three claims in Cannon's Amended Complaint are for violation of Wis. Stat. § 551.501(2), intentional misrepresentation, and breach of fiduciary duty. Am. Compl. ¶¶ 54-71. Typically, state-law claims for damages are not permitted as standalone claims once a debtor files bankruptcy and receives a discharge. Presumably, Cannon brings the first three claims as a means to establish Johnson's liability for an underlying debt because a nondischargeability action under § 523(a) "involves two separate elements: (1) liability for a debt, and (2) the dischargeability of that debt." *In re Hoven*, 652 B.R. 531, 538 (Bankr. W.D. Wis. 2023). Cannon alleges in the last paragraph in each of Counts 4 through 8 that she is entitled to judgment against Johnson "finding all or a portion of the amounts owed to [Cannon] as a result of counts 1-3 . . . to be non-dischargeable."

Johnson's liability for a debt may not be in dispute. On his Schedule E/F in the main bankruptcy case, Johnson listed an unsecured debt owed to Cannon in the amount of $38,342.40, and he did not characterize it as contingent, unliquidated, or disputed. *See* Case No. 23-11365, ECF No. 17 at 16 & ECF No. 27 at 13.[1] Any debt established under non-bankruptcy law will suffice as long as it also meets the elements of an exception to discharge under § 523(a). *Grogan v. Garner*, 498 U.S. 279, 284-85 n.12 (1991) (noting that a creditor can establish an underlying debt "by proving, for example, a breach of contract involving the same transaction"); *see also In re McClure*, 625 B.R. 733, 738-39 (Bankr. C.D. Ill. 2021) ("Even if such a creditor is unable to establish a debt for fraud under state law, she may yet hold a claim for a separate debt, provable by a preponderance of the evidence and arising out of the same transaction, that is itself actionable under § 523(a)(2)(A).").

Therefore, it may be that the Court does not need to adjudicate the merits of the state-law claims in Counts 1 through 3 if Johnson agrees there is an underlying debt and the only issue is the dischargeability of that debt. But it is too early in the case to make that determination. Because Counts 1 through 3 are not actionable as standalone claims in the absence of a declaration that the debt is not dischargeable, the Court will address them below in the context of Cannon's nondischargeability claims.

Count 4: Nondischargeability Under 11 U.S.C. § 523(a)(2)(A)

Cannon claims that the debt owed to her is nondischargeable under 11 U.S.C. § 523(a)(2)(A). That section excepts from discharge any debt "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a

[1] Cannon may dispute the amount. Her Amended Complaint asks the Court to award damages but does not demand for a specific amount, asking that the damages "be determined at trial." Am. Compl. at 13.

false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(A). To except a debt from discharge under § 523(a)(2)(A), the creditor must prove the existence of a debt along with the following three elements: (1) that the debtor made a false representation or omission, which the debtor either knew was false or made with reckless disregard for the truth; (2) that the debtor possessed an intent to deceive or defraud; and (3) that the creditor justifiably relied on the false representation. *Reeves v. Davis (In re Davis)*, 638 F.3d 549, 553 (7th Cir. 2011); *see also Ojeda v. Goldberg*, 599 F.3d 712, 716-17 (7th Cir. 2010). "A debtor's failure to disclose pertinent information may be a false representation where the circumstances imply a specific set of facts and disclosure is necessary to correct what would otherwise be a false impression." *In re Ryan*, 408 B.R. 143, 157 (Bankr. N.D. Ill. 2009).

As noted, Johnson seems to agree that he owes a debt to Cannon. To the extent Cannon relies on an intentional misrepresentation claim under Wisconsin law for the underlying debt, the elements of that claim are: "(1) the defendant made a representation of fact; (2) the representation was untrue; (3) the defendant made the representation either knowing that it was untrue, or recklessly not caring whether it was true or false; (4) the defendant made the representation with the intent to deceive the plaintiff in order to induce the plaintiff to act on it to plaintiff's pecuniary damage; and (5) the plaintiff believed that the representation was true and relied on it." *Malzewski v. Rapkin*, 2006 WI App 183, ¶ 17, 296 Wis. 2d 98, 111, 723 N.W.2d 156, 162. The first three elements of an intentional misrepresentation claim under Wisconsin law overlap with the first element of a nondischargeability claim under § 523(a)(2)(A), and the fourth and fifth elements under Wisconsin law overlap with the second and third elements under

§ 523(a)(2)(A). The Court will therefore address the elements of the Wisconsin intentional misrepresentation claim because satisfaction of those elements would also satisfy § 523(a)(2)(A).

First, Cannon sufficiently alleges that Johnson made a false representation of fact. She alleges that "Johnson represented to [Cannon] that her funds would be used to prepare the restaurant and bed and breakfast properties to open for business." Am. Compl. ¶ 20. She also alleges that Johnson "intentionally mis[led] [Cannon] into believing her investment funds would only be used towards furtherance of the businesses she believed she was investing in." *Id.* ¶ 73. In addition, Cannon incorporates by reference the DFI's Consent Order, in which DFI stated that "Johnson represented to Investor DC that her funds would be used to prepare the restaurant and bed and breakfast properties to open for business." *Id.* Ex. B at 3, ¶ 14.[2]

Johnson argues that the note was issued by Ocooch, not him personally, and that he "never spoke with [Cannon] or made any representations on behalf of Ocooch." ECF No. 14 at 5.[3] Johnson also argues that any statement related to the use of the funds was "open to multiple interpretations" and that "the most reasonable interpretation" of the representation would allow Ocooch to pay Johnson and his receptionist for their labor in fixing up the restaurant and bed and breakfast. ECF No. 19 at 4. These are factual issues to be resolved at trial. It may be that

[2] Cannon also alleges that Johnson committed misrepresentation by omission when he did not disclose to her that he had filed bankruptcy in 1998 and that the Wisconsin Department of Revenue had filed a tax lien against Johnson in August 2019. Am. Compl. ¶¶ 61, 73. There are no allegations in the Amended Complaint, and no argument in Cannon's brief in response to Johnson's motion to dismiss, that would support an inference that Johnson had a duty to disclose these details or that disclosure of these details was necessary to correct a false impression. Cannon also does not allege facts supporting an inference that she relied on the non-existence of these facts to make her investment.

[3] To the extent Johnson argues that he cannot be liable because Cannon loaned the money to Ocooch and not to him personally, that argument fails. *See In re Bloom*, 634 B.R. 559, 597 (B.A.P. 10th Cir. 2021), *aff'd*, No. 22-1005, 2022 WL 2679049 (10th Cir. July 12, 2022) (debt could be nondischargeable under § 523(a)(2)(A) even though debtor's company was the "direct recipient of the benefits of his deceitful conduct"); *In re Speisman*, 495 B.R. 398, 403 (Bankr. N.D. Ill. 2013) ("courts have not required the debtor to have received any benefit, direct or indirect, for there to be a violation of section 523(a)(2)(A)").

Johnson and his receptionist did perform compensable manual labor on behalf of Ocooch, that the labor was in furtherance of preparing the properties to open for business, and that Cannon should not have assumed that preparing the properties would not include paying for Johnson's labor. At this stage, however, the Court is required to accept as true Cannon's allegation that Johnson made a representation to her regarding the intended use of the funds and that the representation suggested to her that the funds she invested would not be used to pay Johnson himself. *See* Am. Compl. ¶ 40.

Johnson also complains that Cannon's allegations regarding his representation do not meet the heightened pleading standard of Rule 9(b). Quoting *Uni*Quality, Inc. v. Infotronx, Inc.*, 974 F.2d 918, 923 (7th Cir. 1992), Johnson argues that Cannon must specifically "state the identity of the person making the misrepresentation, the time, place, and content of the misrepresentation, and the method by which the misrepresentation was communicated to the plaintiff." ECF No. 19 at 3. He posits that Cannon needs to allege exactly what he said and how he said it – whether, for example, in an email, text, or in-person conversation. *Id.* at 3-4. Johnson wants far more detail than is required. Cannon sufficiently pleaded that Johnson made a representation regarding how her funds would be used, that the representation was made in early 2020, and that Cannon and Johnson were in the Wilton, Wisconsin and Kendall, Wisconsin[4] area at the time. Cannon need not "supply exact dates or locations or a word for word recitation of the representation." *In re Jacobs*, 403 B.R. 565, 575 (Bankr. N.D. Ill. 2009). The allegations are enough to put Johnson on notice of the purported fraud he needs to defend against.

Second, Cannon sufficiently alleges that the representation made by Johnson was untrue. According to Cannon, she and her brother-in-law loaned Ocooch $36,000 between January 31,

[4] The towns are approximately 10 miles apart and are both in Monroe County, a rural area of Wisconsin.

2020 and February 20, 2020. Am. Compl. ¶¶ 16, 23-26. She also alleges that Johnson caused Ocooch to make payments to himself and his receptionist of approximately $12,814.12 between January 29, 2020 and March 31, 2020, and that the balance in Ocooch's bank account on January 29, 2020 was $200. *Id.* ¶¶ 35, 38. Cannon's allegations suggest that the Ocooch bank account did not have sufficient funds to make payments to Johnson without the influx of cash from Cannon and her brother-in-law, and that, based on the timing of the payments to Johnson, Johnson expected to pay himself from the loaned money. Therefore, Cannon sufficiently alleges that Johnson's representation that the funds would be used solely to prepare the restaurant and bed and breakfast properties, and the related implication the funds would not be used to pay Johnson himself, was untrue.

In addition, Johnson agreed to the Consent Order, which concluded that he had committed securities fraud under Wisconsin law. The relevant Wisconsin statute provides that it is unlawful to, in connection with the offer, sale, or purchase of a security, "make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Wis. Stat. § 551.501(2). The Consent Order states that Johnson violated § 551.501(2) when he failed to disclose that Cannon's funds would be used to pay Johnson and his receptionist. Am. Compl. Ex. B at 5, ¶ 34. Johnson has therefore already agreed that the statement he made was untrue or omitted a material fact necessary to make the statement not misleading.

Third, Cannon alleges that Johnson made the representation either knowing that it was untrue, or recklessly not caring whether it was true or false. *See* Am. Compl. ¶¶ 62, 74. Knowledge may be alleged generally under Rule 9(b), and the Seventh Circuit has held that "the scienter element of a section 523(a)(2)(A) claim . . . may logically be inferred from a false

representation which the debtor knows or should know will induce another to make a loan." *In re Kimzey*, 761 F.2d 421, 424 (7th Cir. 1985). Because knowledge may be alleged generally, Cannon's allegation regarding Johnson's knowledge may be sufficient on its own to satisfy the third element. But Cannon's allegation is also supported by facts alleged in the Amended Complaint. If Ocooch had only $200 left before receiving the loans from Cannon and her brother-in-law, and Ocooch started paying Johnson before Ocooch received Cannon's money, it is reasonable to infer that Johnson knew the funds that Cannon invested would be used to continue those payments and would not be used solely for other necessary expenses to prepare the restaurant and bed and breakfast.

Fourth, Cannon alleges that Johnson made the representation with the intent to deceive her and to cause her to invest in Ocooch. Am. Compl. ¶¶ 50, 63, 75. Allegations of intent may be alleged generally, *see Kimzey*, 761 F.2d at 424, so Cannon's allegations regarding Johnson's intent may be sufficient on their own. The allegations are also supported by facts. By the time Cannon and her brother-in-law invested, Ocooch had little money available. Johnson would know that if he intended to receive payments from Ocooch then those payments would need to come from the funds loaned by Cannon. By implying that the funds would not be used to pay himself, there is a reasonable inference that Johnson intended to deceive Cannon regarding the true purpose of the loan. Also, Cannon alleges that she "made several attempts" to obtain an accounting of how her funds were used from Johnson and Ocooch, but they did not respond, which suggests that Johnson did not want to inform Cannon regarding the true use of her funds.

Am. Compl. ¶ 33. At this stage, these facts support an inference that Johnson intended to deceive Cannon about the uses to which her funds would be put.[5]

Johnson argues that the allegations are insufficient to prove that he had an intent to deceive because Ocooch made some payments to Cannon on the note, and Ocooch's mere inability to pay is not sufficient for a fraud claim. ECF No. 14 at 5-7. But Cannon's argument is not based on Ocooch's inability to pay. She alleges that Johnson knew the funds would be used to pay Johnson and his receptionist and that he intended to deceive her by representing that the payments would be used only for other expenses related to preparing the restaurant and bed and breakfast. Just because some of the loan was repaid does not mean that Johnson did not commit fraud in causing Cannon to make the loan.

Fifth, Cannon alleges that she relied on Johnson's representations to her detriment. Am. Compl. ¶¶ 22, 40. Cannon's Wisconsin common law fraud claim and her § 523(a)(2)(A) claim both require that the reliance be justifiable. *See Malzewski*, 2006 WI App 183, ¶ 18; *Ojeda*, 599 F.3d at 717. "Under the justifiable reliance standard, a creditor has no duty to investigate unless the falsity of the representation would have been readily apparent." *Ojeda*, 599 F.3d at 717. "A victim who lacks access to the truth, and has not been alerted to facts that would alert him to the truth, is not to be . . . blocked by a discharge under the bankruptcy laws . . . just because he did not conduct a more thorough investigation." *Mayer v. Spanel Int'l Ltd.*, 51 F.3d 670, 676 (7th Cir. 1995).

[5] In his reply brief, Johnson relies on cases from the Federal Circuit addressing the doctrine of inequitable conduct as it relates to patent invalidity. *See* ECF No. 19 at 5-6 (citing *Hoffmann-La Roche, Inc. v. Promega Corp.*, 323 F.3d 1354 (Fed. Cir. 2003); *Therasense, Inc. v. Becton, Dickinson & Co.*, 649 F.3d 1276 (Fed. Cir. 2011); and *Scanner Techs. Corp. v. ICOS Vision Sys. Corp.*, 528 F.3d 1365, 1376 (Fed. Cir. 2008)). Johnson does not explain how the elements of that doctrine are relevant to the elements of a common law misrepresentation claim or nondischargeability under § 523(a)(2). Moreover, the decisions discuss the standard to be applied when finding facts after a trial. This case is at the motion to dismiss stage. The Court is not finding facts but must accept as true the facts alleged in the complaint and the reasonable inferences drawn therefrom. *See Gibson*, 910 F.2d at 1520-21.

Johnson's argument on this element is limited to two sentences in his reply brief. He asserts that Cannon "fails to sufficiently plead that she was injured as a result of the alleged omissions" because she alleges only that she "was not repaid her full investment." ECF No. 19 at 7. But Cannon plausibly alleges that she agreed to invest in Ocooch "[i]n reliance on Johnson's representations." Am. Compl. ¶ 22. That is, Cannon alleges that she agreed to lend money to Ocooch based on Johnson's representation that funds would be used to prepare the restaurant and bed and breakfast properties and not to pay himself and his receptionist. This is enough at this stage of the litigation.

The Amended Complaint sufficiently alleges a claim under § 523(a)(2)(A). The Court will therefore deny Johnson's motion to dismiss Count 4 of the Amended Complaint. The Court will also deny Johnson's motion to dismiss Count 2 for intentional misrepresentation, but only to the extent that claim is used to satisfy the underlying debt element of the nondischargeability claims.

Count 5: Nondischargeability Under 11 U.S.C. § 523(a)(4)

Section 523(a)(4) excepts from discharge debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4). Though Cannon briefly mentions larceny and embezzlement in her response brief (*see* ECF No. 18 at 10), the Amended Complaint includes no allegations regarding embezzlement or larceny. The Court therefore addresses only whether Cannon sufficiently pleaded that the debt owed to her is for fraud or defalcation while acting in a fiduciary capacity.

To the extent Cannon relies on her breach of fiduciary duty claim in Count 3 to create the underlying debt, the elements of claim for breach of fiduciary duty under Wisconsin law are: "(1) the defendant owed the plaintiff a fiduciary duty; (2) the defendant breached that duty; and (3) the breach of duty caused the plaintiff's damage." *Berner Cheese Corp. v. Krug*, 2008 WI 95,

¶ 40, 312 Wis. 2d 251, 270, 752 N.W.2d 800, 809. As to nondischargeability, a claim under the fiduciary capacity prong of § 523(a)(4) has two elements: (1) "the debtor acted as a fiduciary to the creditor at the time the debt was created," and (2) "the debt was caused by fraud or defalcation." *In re Berman*, 629 F.3d 761, 765-66 (7th Cir. 2011). The first element can often be proven by showing a fiduciary relationship under state law, but "[n]ot all persons treated as fiduciaries under state law are considered to 'act in a fiduciary capacity' for purposes of federal bankruptcy law." *Id*. at 767.

"[A] fiduciary relationship exists for purposes of nondischargeability if there is substantial inequality in power or knowledge in favor of the debtor seeking the discharge and against the creditor resisting discharge and this gives the former a position of ascendancy over the latter because of the special confidence the principal reposes in the fiduciary." *In re Gibson*, 521 B.R. 645, 657 (Bankr. W.D. Wis. 2014) (internal quotations omitted). Key to finding such a relationship is a "special confidence" between the parties that "justif[ies] the imposition on the fiduciary to treat his principal's affairs with all the solicitude that he would accord to his own affairs[.]" *In re Petti*, 2022 WL 3973380, at *7 (Bankr. N.D. Ill. Aug. 31, 2022).

The Seventh Circuit's decision in the *Berman* case is illustrative. There, the creditor hired Berman's company to place advertisements on the creditor's behalf. *Berman*, 629 F.3d at 764. The company did not use some of the funds it received from the creditor to place advertisements, and the creditor alleged that the company and Berman breached a fiduciary duty owed to the creditor. *Id.* at 765. The Seventh Circuit affirmed dismissal of the claim. The court held that the substance of the relationship between the creditor and the company did not qualify it as a fiduciary relationship under § 523(a)(4). *Id.* at 771. The relationship did not involve any

"special confidences" and was an ordinary principal-agent, buyer-seller, or creditor-debtor relationship, which did not trigger a fiduciary duty. *Id.*

Here, Cannon does not sufficiently allege that Johnson was a fiduciary or owed a fiduciary duty to Cannon. Cannon merely loaned money to Ocooch. Like the creditor in *Berman*, Cannon believed and intended that Ocooch would use the money for a certain purpose. And like the company in *Berman*, Ocooch's only duty was to honor the promissory note by repaying the amount loaned.

Cannon alleges that she "entrusted her money with Johnson," that he "solely controlled" Ocooch, and that he therefore owed her a fiduciary duty. She cites the general principle that a fiduciary is someone "in whom confidence is reposed is entrusted with another person's money for safekeeping." *Berman*, 629 F.3d at 768 (internal quotation omitted). Cannon does not, however, cite any cases in which a court found a fiduciary duty in a relationship similar to the one she had with Johnson and Ocooch. This is not a case in which a minority shareholder entrusts complete control of a corporation. *See In re Frain*, 230 F.3d 1014, 1017 (7th Cir. 2000) (finding a fiduciary duty because "the concentration of power was substantially one-sided"). Cannon was a mere creditor of Ocooch; she was not a shareholder. She was entitled to receive repayment of the loan and nothing more. That Johnson may have made misrepresentations to induce her to loan money to the corporation did not make him a fiduciary over the funds she ultimately loaned.

The Court will therefore dismiss Count 5 of the Amended Complaint seeking a determination of nondischargeability under § 523(a)(4). The Court will also dismiss Count 3 because Cannon cannot maintain a standalone claim for breach of fiduciary duty under state law in the absence of a nondischargeability claim.

Count 6: Nondischargeability Under 11 U.S.C. § 523(a)(6)

Section 523(a)(6) excepts from discharge debts "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). The Seventh Circuit has said that a willful and malicious injury "is one that the injurer inflicted knowing he had no legal justification and either desiring to inflict the injury or knowing it was highly likely to result from his act." *Jendusa-Nicolai v. Larsen*, 677 F.3d 320, 324 (7th Cir. 2012). In general, "the statute excepts debts resulting from intentional torts." *In re Krook*, 615 B.R. 479, 487 (Bankr. N.D. Ill. 2020). Fraud is an intentional tort, so it will usually support a claim under § 523(a)(6). *Id.* The Court has already concluded that Cannon sufficiently pleaded that Johnson made a false representation with an intent to deceive – that is, that he intended to injure Cannon by inducing her to part with her funds based on his representations. Because Count 4 states a claim under § 523(a)(2)(A), Count 6 states a claim under § 523(a)(6).

Counts 7 and 8: Nondischargeability Under 11 U.S.C. § 523(a)(19)

Section 523(a)(19) excepts from discharge any debt that

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

11 U.S.C. § 523(a)(19) (emphasis added).

The Amended Complaint alleges two separate counts under § 523(a)(19) – Count 7 for a determination of nondischargeability under § 523(a)(19)(A) and Count 8 for a determination of nondischargeability under § 523(a)(19)(B). Those two subsections are not separate exceptions to discharge. Rather, as the quoted language above makes clear, the two subsections are separated by "and," which requires satisfaction of both (A) and (B) for the debt to be nondischargeable. Therefore, the Court has construed Counts 7 and 8 to be a single claim for a declaration of nondischargeability under § 523(a)(19).

A claim under § 523(a)(19) has two elements: (1) "the debt stems from a violation of securities laws or a fraud in connection with the purchase or sale of a security"; and (2) "the debt is memorialized in a judicial or administrative order or settlement agreement." *In re Clements*, 570 B.R. 803, 808 (Bankr. W.D. Wis. 2017). The Amended Complaint sufficiently pleads both elements.

As to the first element, Cannon alleges that Johnson violated state securities laws, specifically Wis. Stat. § 551.501(2). Am. Compl. ¶¶ 57, 91. This allegation is supported by the Consent Order attached to the Amended Complaint as Exhibit B. In the Consent Order, DFI concluded that Johnson violated Wis. Stat. § 551.501(2) when he omitted the fact that Cannon's funds would be used to pay Johnson and his receptionist. *Id.* Ex. B. at 5, ¶ 34.

Wisconsin law provides that a person who violates § 551.501(2) is liable for damages if "the purchaser [of a security] did not know the untruth or omission." Wis. Stat. § 551.509(2); *see also* Wis. Stat. § 551.509(7) (providing joint and several liability in certain circumstances). As discussed above, Cannon alleges that she did not know her funds would be used to pay Johnson and his receptionist and that she relied on Johnson's representations implying that the funds would not be so used. These allegations are sufficient to allege an underlying debt that is

for violation of securities laws. For the same reasons, they are sufficient to sustain Cannon's claim for violation of Wis. Stat. § 551.501(2) in Count 1 to the extent Cannon relies on that claim to supply the underlying debt.

The second element requires that there be an order or settlement agreement that liquidates and sets the creditor's damages. *See* 11 U.S.C. § 523(a)(19)(B). The Consent Order did not award Cannon any damages from Johnson's violation of Wisconsin securities laws, so that order cannot satisfy § 523(a)(19)(B). Johnson argues a separate order or settlement agreement is necessary for the debt to be declared nondischargeable. Cannon argues that this Court can enter the required order memorializing the debt.

When § 523(a)(19) was first added to the Bankruptcy Code in 2002, subsection (B) simply provided that the debt "results from . . . (i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding . . . ." 11 U.S.C. § 523(a)(19) (2002). The legislative history indicates that "Congress sought to assure that judgments and settlements in state court fraud cases would be nondischargeable without the need for relitigation." *Holzhueter v. Groth (In re Holzhueter)*, 571 B.R. 812, 823 (Bankr. W.D. Wis. 2017); *see also* 148 Cong. Rec. S7418, 7419 (July 26, 2002) (statement of Senator Leahy) ("Under current laws, State regulators are often forced to 'reprove' their fraud cases in bankruptcy court to prevent discharge because remedial statutes often have different technical elements than the analogous common law causes of action.").

In 2005, Congress amended the language of subsection (B) to its current form, adding language that is decisive here. The exception is now for any debt that "(B) results, ***before, on, or after the date on which the petition was filed***, from . . . (i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding . . . ." 11 U.S.C.

§ 523(a)(19) (2024) (emphasis added). "The plain language [of the amendment] eliminates the temporal constraint that the [order or settlement agreement] existed before the bankruptcy was filed." *Holzhueter*, 571 B.R. at 822; *see also In re Hill*, 495 B.R. 646, 656 (Bankr. D.N.J. 2013) ("BAPCPA made it clear that such a race to the bankruptcy court would not disable this exception to discharge [under § 523(a)(19)].").

Following the amendment, a question arose whether the operative order must be entered in a non-bankruptcy forum, or whether the bankruptcy court could enter an order that would satisfy subsection (B) of § 523(a)(19). *See* Collier on Bankruptcy ¶ 523.27[2] (Richard Levin & Henry J. Sommer eds., 16th ed. 2024). Some courts have held that the relevant order must be entered in a non-bankruptcy forum, and that it must "exist prior to a determination of nondischargeability." *In re Jafari*, 401 B.R. 494, 499 (Bankr. D. Colo. 2009); *see also In re Bundy*, 468 B.R. 916, 921 (Bankr. E.D. Wash. 2012) (holding that the 2005 amendment "does not change the conclusion of whether a bankruptcy court has the authority to make the determination"); *In re Pujdak*, 462 B.R. 560, 574 (Bankr. D.S.C. 2011) ("The inclusion of § 523(a)(19)(B) strips the bankruptcy court of its ability to determine whether the debtor did in fact violate the securities laws.").

Other courts have held that bankruptcy courts are among the federal courts that have the power to enter the judgment or order required under subsection B. *Holzhueter*, 571 B.R. at 824 ("This Court finds that section 523(a)(19)(B) permits it to hear the controversy and enter a judgment."); *Hill*, 495 B.R. at 661 ("[T]his court has the jurisdiction and authority to enter the 'resulting' judgment (§ 523(a)(19)(B)(i)) for securities law violations (§ 523(a)(19)(A)), in a wide array of adversary proceedings to except debts from discharge."); *In re Jansma*, No. 09 BK

07071, 2010 WL 282511, at *5 (Bankr. N.D. Ill. Jan. 21, 2010) (holding that a judgment or order may be entered in bankruptcy court "as part of the court's determination of dischargeability").

The Court concludes that § 523(a)(19)(B) allows a bankruptcy court to enter the required order. The plain language of subsection B provides that the order may be entered in ***any*** federal judicial proceeding. Those courts concluding that this all-encompassing phrase does not include bankruptcy courts rely on the pre-2005 law, which they say required the order to be entered by a non-bankruptcy court. *See, e.g.*, *In re Bundy*, 468 B.R. at 921 ("If, as originally enacted, there was no question that the bankruptcy court could not determine that a violation of securities laws had occurred, the language in the amendment affected no change in that principle."). But nothing in the text of the statute, either before or after the 2005 amendment, indicates that the order ***must*** be entered in a non-bankruptcy forum. The temporal limitation in the prior version of subsection B meant that the required order ***necessarily*** had to be entered in a non-bankruptcy forum because it had to be entered before the bankruptcy was filed. That was a limitation imposed by the temporal requirement; there was never a limitation in the text as to which federal courts could enter the required order. *See Holzhueter*, 571 B.R. at 823 ("Congress simply closed a temporal loophole expanding the time for a plaintiff to receive a judgment beyond the filing of a bankruptcy petition."). Since the amendment, the judgment or order may be entered at any time and in any federal or state judicial or administrative proceeding, including a federal bankruptcy proceeding.

Contrary to the suggestion of some courts, this conclusion does not render § 523(a)(19)(B) superfluous. *See Bundy*, 468 B.R. at 921 ("allow[ing] a bankruptcy court to decide whether the requirement of § 523(a)(19)(A) [has] been met would render § 523(a)(19)(B) meaningless"). The purpose of § 523(a)(19)(B) is to make clear that a violation of securities

laws alone is not enough; the debt must be affirmatively memorialized by a tribunal or by the debtor himself in a settlement agreement before it will be rendered nondischargeable. Once such an order is entered, there is no need to seek a determination of nondischargeability in the bankruptcy court or any other court unless the debtor disputes whether the elements of § 523(a)(19) have been met. *See* 11 U.S.C. § 523(c)(1) (requiring a determination of nondischargeability only for debts excepted from discharge under § 523(a)(2), (4), and (6)).

If the debt has not been so memorialized before bankruptcy, then the creditor must seek to do so after the petition is filed. The plain language of the statute allows this to be done in "any Federal or State judicial or administrative proceeding." 11 U.S.C. § 523(a)(19)(B)(i). In some cases, it will make sense for the issue to be litigated in a non-bankruptcy forum, such as when a proceeding has already begun in another forum before the petition is filed or when there is a need for a complex proceeding in a specialized forum.

In other cases, it will make more sense for the issues to be litigated in the bankruptcy court. This is one such case. The alleged fraud involves a small number of investors, only one of whom seeks to have an order entered deeming the debt nondischargeable under § 523(a)(19); that creditor has already commenced a nondischargeability proceeding involving other subsections of § 523; and the creditor's claim is not complex and does not require resolution in a specialized forum. To hold that the relevant judgment or order must be entered in a non-bankruptcy forum would require Cannon to obtain relief from the stay and litigate her claim for violation of Wis. Stat. § 551.501(2) in the state court case that was stayed when Johnson filed his petition. This would mean that both Cannon and Johnson would be engaged in two cases over the same set of operative facts. It is far more efficient to litigate the issue in this court. "Rather than 'reading out' Subsection B of § 523(a)(19), full bankruptcy court jurisdiction maximizes

achievement of the purposes of Sarbanes-Oxley, while fostering sensible bankruptcy case administration." *Hill*, 495 B.R. at 660; *see also Holzhueter*, 571 B.R. at 824 ("Determining the claims in this Court will avoid piecemeal litigation, advance a faster resolution of all claims than would result from the piecemeal approach advanced by the State Court Plaintiffs, and will be more cost effective and efficient for all parties.").

For these reasons, the Court will deny the motion to dismiss Count 7/8 of the Amended Complaint. The Court will also deny the motion to dismiss Count 1 to the extent the alleged violation of Wis. Stat. § 551.501(2) supplies the underlying debt for the nondischargeability claim under § 523(a)(19).

CONCLUSION

For the foregoing reasons, IT IS HEREBY ORDERED:

1. Johnson's motion to dismiss (ECF No. 14) is GRANTED IN PART and DENIED IN PART as set forth herein.

2. Count 3 (breach of fiduciary duty) and Count 5 (nondischargeability under § 523(a)(4)) of the Amended Complaint are dismissed without prejudice.

3. Count 4 (nondischargeability under § 523(a)(2)(A)), Count 6 (nondischargeability under § 523(a)(6)), and Count 7/8 (nondischargeability under § 523(a)(19)) are not dismissed.

4. Count 2 (intentional misrepresentation) is not dismissed, but the claim survives only to the extent necessary for Cannon to prove the existence of an underlying debt for her nondischargeability claims under § 523(a)(2)(A) and § 523(a)(6).

5. Count 1 (violation of Wis. Stat. § 551.501(2)) is not dismissed, but the claim survives only to the extent necessary for Cannon to prove the existence of an underlying debt for her nondischargeability claims under § 523(a)(2)(A), § 523(a)(6) and § 523(a)(19).

6. In light of the dismissal of Counts 3 and 5, Cannon is granted leave file a further amended complaint on or before August 15, 2024.

7. If Cannon does not file a further amended complaint by the deadline, the dismissal of Counts 3 and 5 shall be deemed to be with prejudice and Johnson shall respond to the Amended Complaint on or before August 22, 2024.

8. If Cannon does file a further amended complaint by the deadline, Johnson's time to respond shall be governed by Federal Rule of Civil Procedure 15(a)(3), made applicable to this case by Federal Rule of Bankruptcy Procedure 7015.

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