**IT IS SO ORDERED.**

**Dated: July 9, 2014**
**02:01:50 PM**

Kay Woods
**Kay Woods**
**United States Bankruptcy Judge**

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

| | | |
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| IN RE: | * | |
| D.J. HARRIETT, INC., | * | CASE NUMBER 10-43061 |
| Debtor. | * | |
| * * * * * * * * * * * * * * * * | * | |
| MARK A. BEATRICE, TRUSTEE, | * | ADVERSARY NUMBER 12-4098 |
| Plaintiff, | * | |
| v. | * | |
| LINDA P. HARRIETT, *et al.*, | * | |
| Defendants. | * | HONORABLE KAY WOODS |

**********
MEMORANDUM OPINION REGARDING MOTION TO DISMISS
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This cause is before the Court on Motion to Dismiss Adversary Proceeding, Objection to Supplemental Jurisdiction Over Non-Core Proceeding and Motion for Abstention ("Motion to Dismiss") (Doc. 55) filed by Defendants Linda P. Harriett ("Harriet") and The Linda P. Harriett Living Trust ("Harriett Trust") on April 23, 2014. Plaintiff Mark A. Beatrice, Chapter 7 Trustee ("Trustee"), filed Memorandum in Opposition to Motion to Dismiss and Objection to Jurisdiction and Motion for Abstention ("Memo in Opposition") (Doc. 56) on May 8, 2014. For the reasons set forth herein, the Court will deny the Motion to Dismiss.

This Court has jurisdiction pursuant to 28 U.S.C. § 1334 and General Order No. 2012-7 entered in this district pursuant to 28 U.S.C. § 157(a). Venue in this Court is proper pursuant to 28 U.S.C. §§ 1391(b), 1408 and 1409. This is either a core proceeding pursuant to 28 U.S.C. § 157(b)(2) or a non-core proceeding over which the Court has jurisdiction. The following constitutes the Court's findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

## I. PROCEDURAL BACKGROUND

The first step in the Court's analysis is to set forth exactly what this Memorandum Opinion can and will address. The Motion to Dismiss is brought by both Defendants – Harriett and the Harriett Trust. (Mot. to Dismiss at 1.) These Defendants seek an order from the Court dismissing the Amended Complaint (Doc. 50) in its

entirety. (*Id.*) However, the prayer for relief seeks "dismiss[al of] the amended complaint and all claims against the Linda P. Harriett Living Trust." (*Id.* at 6.) Therefore, in accordance with the procedural background described herein, the Court will only address the Motion to Dismiss as it pertains to the claims against the Harriet Trust.

The Trustee filed Motion for Leave to File Amended Complaint ("Motion for Leave") (Doc. 47) on March 19, 2014, in which the Trustee sought to amend the caption of this Adversary Proceeding (i) to name the Harriett Trust as a defendant to conform the caption with allegations regarding the Harriett Trust in the body of the Complaint; and (ii) to correct a typographical error. On March 21, 2014, Harriett filed her Response and Objection (Doc. 48) to the Motion for Leave, in which she opposed adding the Harriett Trust as a defendant. On March 24, 2014, the Court granted Trustee leave to amend the Complaint. The Amended Complaint was filed on March 25, 2014.

The allegations against Harriett in the Amended Complaint are identical to the allegations against her in the Complaint. Harriett filed her Answer (Doc. 5) to the Complaint on September 11, 2012, in which she generally denied the allegations in the Complaint and raised certain affirmative defenses. However, prior to filing her Answer, she did not seek to dismiss the Complaint on the basis that it failed to state a claim upon which

relief can be granted. As proscribed by Federal Rule of Civil Procedure 12(b), made applicable to this proceeding by Federal Rule of Bankruptcy Procedure 7012, a motion based on failure to state a claim upon which relief can be granted "must be made before pleading if a responsive pleading is allowed." As a consequence, it is too late for Harriett to raise a Rule 12(b)(6) motion to dismiss the allegations against her in the Amended Complaint.

Counts I through III assert allegations only against Harriett and not the Harriett Trust. As a consequence, this Court will treat the Motion to Dismiss as seeking dismissal of only Counts IV and V, which assert allegations against the Harriett Trust.

The Motion to Dismiss seeks dismissal of the Amended Complaint on the basis that (i) supplemental jurisdiction is not proper over non-core issues based on state law; (ii) the Court should adhere to mandatory abstention for all state law claims in this proceeding; and (iii) in the alternative, the Counts against the Harriett Trust fail to state a claim upon which relief can be granted.

## II. FACTUAL BACKGROUND

An involuntary petition pursuant to chapter 7 was filed on behalf of Debtor D.J. Harriett, Inc. on September 14, 2010 (Main Case No. 10-43061) following the collapse of its Ponzi scheme. This sham was orchestrated by David J. Harriet ("David"), sole

shareholder of the Debtor, who later pled guilty to federal criminal charges related to operation of the Ponzi scheme.

The Trustee filed the Complaint on August 10, 2012. On March 25, 2014, the Trustee filed the Amended Complaint, which is nearly identical to the Complaint. As set forth above, the Amended Complaint corrects a typographical error and, more significantly, named the Harriett Trust as an additional defendant. The Defendants in the adversary proceeding are (i) Harriett, who was David's spouse; and (ii) Harriett's personal trust. The Trustee seeks turnover of property of the Debtor's estate and to avoid allegedly fraudulent transfers (i) from the Debtor to Harriett (Counts I-III); and (ii) from Harriett to the Harriett Trust (Counts IV-V). Counts I through III allege that, on July 1, 2008, David transferred $231,883.89 from the Debtor's investor funds by wire transfer to Harriett ("Wire Transfer"). (Am. Compl. ¶ 17.) Harriett used the Wire Transfer to purchase real estate at 4601 S. Hassett Circle, Mesa, Arizona ("Property"). (*Id.* ¶¶ 17-18.)

Count IV alleges that Harriett transferred the Property to herself, as trustee for the Harriett Trust, without receiving reasonably equivalent value in exchange for such transfer. (*Id.* ¶ 30.) As a consequence, the Trustee alleges that Harriett's transfer to the Harriett Trust constitutes a fraudulent transfer under Ohio Revised Code § 1336.04(A)(1) or Arizona Revised Statute

§ 44-1004(A)(1).[1] (*Id.* ¶ 30-31.) Count V is similar in that the Trustee alleges Harriett made the transfer of the Property to the Harriett Trust without receiving reasonably equivalent value and that she became insolvent as a result of such transfer. (*Id.* ¶ 33.) As a consequence, the Trustee alleges that he can avoid Harriett's transfer of the Property to the Harriett Trust pursuant to Ohio Revised Code § 1336.05(a) or Arizona Revised Statute § 44-1005. (*Id.*)

## III. STANDARD OF REVIEW

Federal Rule of Civil Procedure 12(b)(6), made applicable to this proceeding by Federal Rule of Bankruptcy Procedure 7012(b), allows a defendant to move for dismissal of a complaint that fails "to state a claim upon which relief can be granted." FED. R. CIV. P. 12(b)(6) (2014). The motion to dismiss will be denied if the complaint contains "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citation omitted). Thus, "to survive a motion to dismiss, the

[1] Throughout the Amended Complaint, the Trustee cites Arizona and Ohio law. Since both support his position and the outcome is not materially different under either state's version of the Uniform Fraudulent Conveyance Act, the Court will focus on Arizona law throughout its analysis since the transactions at issue occurred in Arizona.

complaint must contain either direct or inferential allegations respecting all material elements to sustain a recovery under some viable legal theory." *Eidson v. Tenn. Dep't of Children's Servs.*, 510 F.3d 631, 634 (6th Cir. 2007) (citation omitted).

When evaluating a motion to dismiss, the court must "construe the complaint in the light most favorable to the plaintiff, accept its allegations as true, and draw all reasonable inferences in favor of the plaintiff." *Tam Travel, Inc. v. Delta Airlines, Inc. (In re Travel Agent Comm'n Antitrust Litig.)*, 583 F.3d 896, 903 (6th Cir. 2009) (citation omitted). However, "conclusory allegations or legal conclusions masquerading as factual allegations will not suffice." *Watson Carpet & Floor Covering, Inc. v. Mohawk Indus., Inc.*, 648 F.3d 452, 457 (6th Cir. 2011) (internal citations omitted).

Accordingly, for purposes of determining this Motion to Dismiss, the Court accepts all facts pled in the Amended Complaint as true.

## IV. ANALYSIS

### A. Supplemental Jurisdiction

The Defendants[2] argue that all state law claims in this case are non-core proceedings which require supplemental jurisdiction.

[2] The Motion to Dismiss is brought jointly by Harriett and the Harriett Trust, but it is unclear on what basis Harriett can assert any of the arguments on behalf of the Harriett Trust. To the extent Harriett is acting not in her individual capacity, but in her capacity as trustee of the Harriett Trust, the Court notes that the original Complaint asserted allegations against Harriet in

To the contrary, this Court has "related to" jurisdiction over the Trustee's claims against the Harriett Trust; therefore, supplemental jurisdiction is not an issue.[3]

The claims asserted by the Trustee are related to the Debtor's bankruptcy case and may be appropriately adjudicated by this Court. An expansive test for "related to" jurisdiction has been articulated by the Sixth Circuit as "whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy." *In re Dow Corning Corp.*, 86 F.3d 482, 489 (6th Cir. 1996) (citing *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3rd Cir. 1984) (An action is "related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.")). "Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate." *Celotex Corp. v. Edwards*, 514 U.S. 300, 307-08 (1995).

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both her individual capacity and as trustee of the Harriett Trust. As a consequence, despite the confusion, the Court deems the Motion to Dismiss to be brought by the Harriett Trust as it relates to Counts IV and V.

[3] The Defendants ignore "related to" jurisdiction in their unsupported legal conclusion that all state law claims in non-core proceedings require supplemental jurisdiction. (*See* Mot. to Dismiss at 4.)

In the Amended Complaint, the Trustee asserts claims on behalf of the bankruptcy estate seeking to recover property of the estate (*i.e.*, funds in the amount of $231,883.89 that were wire transferred by the Debtor to Sun Title Agency for the purpose of Harriett's purchase of the Property and Harriett's subsequent transfer of the Property to the Harriett Trust). These claims are brought by the Trustee on behalf of the Debtor's bankruptcy estate and could "conceivably have an effect on the estate."

The Arizona Revised Statutes provide for permissible recoveries for a creditor in a fraudulent conveyance action:

> A. In an action for relief against a transfer or obligation under this article, a creditor, subject to the limitations in §§ 44-1008 and 44-1009, may obtain one or more of the following remedies:
>
> 1. Garnishment against the fraudulent transferee or the recipient of the fraudulent obligation, in accordance with the procedure prescribed by law in obtaining such remedy.
>
> 2. Avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim.
>
> 3. An attachment or other provisional remedy against the asset transferred or other property of the transferee in accordance with the procedure prescribed by law in obtaining such remedy.
>
> 4. 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.
>
> (c) Any other relief the circumstances may require.
>
> B. Subject to the limitations in §§ 44-1008 and 44-1009, if a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, may levy execution on the asset transferred or its proceeds.

ARIZ. REV. STAT. ANN. § 44-1007 (2014) (emphasis added). As allowed by this statute, the potential outcome of each of the Trustee's claims pursuant to Arizona's fraudulent transfer statutes, §§ 40-1004 and 40-1005, could bring money or property into the bankruptcy estate. Accordingly, the Court has "related to" jurisdiction and need not address the issue of supplemental jurisdiction.

**B. Abstention**

Next, the Defendants request this Court to abstain from all state law claims and "allow the state courts to handle such." (Mot. to Dismiss at 5.) To support this alternative grounds for dismissal, the Defendants urge the application of mandatory abstention,[4] which requires satisfaction of all six criteria articulated in the United States Code. The burden to prove each of the elements lies with the moving party. 28 U.S.C. § 1334(c)(2) (2014).

[4] Permissive abstention was not raised by the Defendants.

Mandatory abstention, governed by 28 U.S.C. § 1334(c)(2), requires that the proceeding (i) be based on a state law claim or cause of action; (ii) lack a federal jurisdictional basis absent the bankruptcy; (iii) be commenced in a state forum of appropriate jurisdiction; (iv) be capable of timely adjudication; and (v) be a non-core proceeding. *In re Lowenbraun*, 453 F.3d 314, 320 (6th Cir. 2006) (citing *In re Dow Corning Corp*, 86 F.3d at 497); *See In re Semcrude, L.P.*, No. 08-11525, 2010 WL 5140487 (Bankr. D. Del. Dec. 13, 2010) (enumerating the sixth element as "the motion to abstain is timely").

"The mere presence of state law issues is not enough to warrant abstention since virtually every issue which arises within the context of a bankruptcy case involves state law to at least some degree." *In re Ascher*, 128 B.R. 639, 647 (Bankr. N.D. Ill. 1991) (citations omitted). The Defendants do not allege that any state court proceeding on these claims has already commenced. In addition, because no action has been commenced in state court whereas this adversary proceeding has been pending in this Court for approximately two years, the element of timely adjudication is also lacking.

Therefore, the Defendants have not satisfied their burden to establish the existence of all six elements. Accordingly, there is no valid justification for mandatory abstention.

**C. Failure to State a Claim**

The Defendants also move to dismiss the Amended Complaint on the basis that the Trustee's allegations, even if accepted as true, do not state a claim upon which relief can be granted because the Harriett Trust is not liable to the Debtor, as it is merely the recipient of a "re-transfer" of estate property. (Mot. to Dismiss at 3.) Addressing only one of the two claims against the Harriett Trust, Count IV but not Count V, the Defendants argue that the Trustee did not allege that the Debtor transferred any assets to the Harriett Trust, nor did any party on the Debtor's behalf transfer assets to the Harriett Trust. (*Id.* at 2.) The Defendants argue that the re-transfer by Harriett of the Property to the Harriett Trust does not "fall within the description of transfer since this is a re-transfer following a transfer." (*Id.* at 3.) Specifically, the Defendants contend that "the Trustee cannot simply follow a pot of money from person to person to person no matter how many times it has been transferred all within the original action for fraudulent transfer within the bankruptcy case." (*Id.*)

Rather, the Trustee's Amended Complaint alleges "that [David] caused investor funds intended for the Debtor, constituting property of the estate, to be transferred to [Harriet] to fund her purchase of the [Property]." (Memo in Opposition at 2.) The Amended Complaint sets forth two state law claims against the

Harriett Trust for violations of uniform fraudulent conveyance statutes based on Harriett's conveyance of the Property to the Harriett Trust "at a time when the Debtor had a claim against [ ] Harriett." (*Id.* at 3.)

The Trustee's claims against the Harriett Trust are viable pursuant to § 550 of the Bankruptcy Code, which states:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, <u>the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from–</u>
>
> > (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
> >
> > (2) <u>any immediate or mediate transferee of such initial transferee</u>.

11 U.S.C. § 550(a) (2014).

The Trustee is authorized to pursue the bankruptcy estate's claims against the "initial transferee" and the "immediate or mediate transferee" of the initial transferee. The Trustee has the power to step into a creditor's shoes to pursue causes of action that existed as of the commencement of the bankruptcy case. 11 U.S.C. § 544(b). One such claim is based on the Debtor's alleged transfer of investor funds to Harriett for Harriett's purchase of the Property. Because Harriett transferred the Property from herself in her individual capacity to herself as trustee of the Harriett Trust, both Harriett, in her individual

capacity, and Harriett, as trustee of the Harriett Trust, may be liable for the fraudulent conveyance.

The Defendants' main argument for dismissal is that the Harriett Trust is merely the recipient of a re-transfer from Harriett. However, the Bankruptcy Code confirms that a subsequent transfer remains subject to the Trustee's avoidance powers pursuant to § 550. According to Arizona law, judgment for violations of the state's Uniform Fraudulent Transfer Act may be entered against either: (i) the "first transferee of the asset or the person for whose benefit the transfer was made;" or (ii) "any subsequent transferee other than a good faith transferee who took for value or from any subsequent transferee." ARIZ. REV. STAT. ANN. § 44-1008(B) (2014).[5]

This theory of subsequent transferee liability is well settled in Arizona. *See Peabody Consol. Copper Co. v. Maier*, 20 Ariz. 370, 376-77 (1919) ("The law imputes the fraud from the acts, conveyances, and transfers when they result in a wrong to another, in violation of a duty owing. The grantee receives and holds the title acquired in each circumstances in trust, subject to the claims of the persons wronged, provided the grantee is chargeable with notice of such wrong as a fact.").

[5] Analogous to OHIO REV. CODE ANN. § 1336.08 (2014).

The fact that the Harriett Trust is an irrevocable trust is irrelevant to the analysis of liability for a subsequent transfer. "[E]very conveyance made by a person who is thereby rendered insolvent is fraudulent" and "his creditors may execute on the property conveyed." *Sackin v. Kersting*, 468 P.2d 925 (Ariz. 1970). Although some exceptions may protect good faith transferees or bona fide purchasers, those exceptions are typically absent when a transfer is made without reasonably equivalent consideration to a personally controlled irrevocable trust. As explained by the Supreme Court of Arizona, "It does not matter that the property had been conveyed to an irrevocable trust; the statute does not recognize exceptions for trusts in directing that executions may lie against the property conveyed." *Sackin v. Kersting*, 466 P.2d 758, 759 (Ariz. 1970) (opinion supplemented on rehearing, 468 P.2d 925 (Ariz. 1970)).

This Court concludes that the Trustee has sufficiently pled his claim that the Harriet Trust is the "immediate or mediate transferee" and that its receipt of the Property may constitute an avoidable transfer. As a consequence, the Court finds that the Trustee has stated a plausible claim for the alleged fraudulent conveyance against the Harriett Trust. Accordingly, the Court will deny the Defendants' Motion to Dismiss.

## IV. CONCLUSION

As set forth above, the Defendants have failed to establish a valid legal basis for dismissal. None of the Defendants' arguments require this Court to dismiss the Amended Complaint: (i) supplemental jurisdiction is not required for this Court to adjudicate the Trustee's claims against Harriett and the Harriett Trust; (ii) the Defendants failed to satisfy all the required criteria for mandatory abstention; and (iii) the Amended Complaint contains enough factual support and plausibility to survive Rule 12(b)(6).

The Motion to Dismiss will be denied. An appropriate order will follow.

# # #

**IT IS SO ORDERED.**

**Dated: July 9, 2014**
**02:01:50 PM**

Kay Woods
**Kay Woods**
**United States Bankruptcy Judge**

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

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| IN RE: | * | |
| D.J. HARRIETT, INC., | * | CASE NUMBER 10-43061 |
| Debtor. | * | |
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| Plaintiff, | * | |
| v. | * | |
| LINDA P. HARRIETT, *et al.*, | * | |
| Defendants. | * | HONORABLE KAY WOODS |

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ORDER DENYING MOTION TO DISMISS

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This cause is before the Court on Motion to Dismiss Adversary Proceeding, Objection to Supplemental Jurisdiction Over Non-Core Proceeding and Motion for Abstention ("Motion to Dismiss") (Doc. 55) filed by Defendants Linda P. Harriett ("Harriet") and The Linda P. Harriett Living Trust ("Harriett Trust") on April 23, 2014. The Motion to Dismiss seeks dismissal of the Amended Complaint (Doc. 50) on the basis that (i) supplemental jurisdiction is not proper over non-core issues based on state law; (ii) the Court should adhere to mandatory abstention for all state law claims in this proceeding; and (iii) in the alternative, the Counts against the Harriett Trust fail to state a claim upon which relief can be granted.[1] Plaintiff Mark A. Beatrice, Chapter 7 Trustee ("Trustee"), filed Memorandum in Opposition to Motion to Dismiss and Objection to Jurisdiction and Motion for Abstention (Doc. 56) on May 8, 2014.

For the reasons set forth in the Court's Memorandum Opinion Regarding Motion to Dismiss entered on this date, the Court hereby:

1. Finds that supplemental jurisdiction is not required for this Court to adjudicate the Trustee's fraudulent conveyance claims against Harriett and the Harriett Trust because the Court has "related to" jurisdiction to adjudicate such claims;

[1] The Court only addresses the Counts IV and V, which assert allegations against the Harriett Trust, as Harriett has waived her right to bring a motion to dismiss for failing to state a claim upon which relief can be granted.

2. Finds that the Defendants failed to satisfy all the required criteria for mandatory abstention;

3. Finds that Counts IV and V of the Amended Complaint state a claim upon which relief can be granted; and

4. Denies the Motion to Dismiss in its entirety.

# # #