UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

Honorable Fredrick E. Clement
Fresno Federal Courthouse
2500 Tulare Street, 5th Floor
Courtroom 11, Department A
Fresno, California

PRE-HEARING DISPOSITIONS

DAY: WEDNESDAY
DATE: AUGUST 14, 2019
CALENDAR: 3:30 P.M. CHAPTERS 13 AND 12 ADVERSARY PROCEEDINGS

Each matter on this calendar will have one of three possible designations: No Ruling, Tentative Ruling, or Final Ruling. These instructions apply to those designations.

No Ruling: All parties will need to appear at the hearing unless otherwise ordered.

Tentative Ruling: If a matter has been designated as a tentative ruling it will be called. The court may continue the hearing on the matter, set a briefing schedule or enter other orders appropriate for efficient and proper resolution of the matter. The original moving or objecting party shall give notice of the continued hearing date and the deadlines. The minutes of the hearing will be the court's findings and conclusions.

Final Ruling: Unless otherwise ordered, there will be no hearing on these matters. The final disposition of the matter is set forth in the ruling and it will appear in the minutes. The final ruling may or may not finally adjudicate the matter. If it is finally adjudicated, the minutes constitute the court's findings and conclusions.

Orders: Unless the court specifies in the tentative or final ruling that it will issue an order, the prevailing party shall lodge an order within 14 days of the final hearing on the matter.

1. 18-14586-A-13 **IN RE: JAMES/LAURA JORGENSEN**
19-1026

RESCHEDULED STATUS CONFERENCE RE: AMENDED COMPLAINT
6-13-2019 [31]

ALUISI ET AL V. JORGENSEN
DAVID JENKINS/ATTY. FOR PL.

No Ruling

2. 18-14586-A-13 **IN RE: JAMES/LAURA JORGENSEN**
19-1026 NEA-2

MOTION TO DISMISS ADVERSARY PROCEEDING/NOTICE OF REMOVAL
7-3-2019 [37]

ALUISI ET AL V. JORGENSEN
NICHOLAS ANIOTZBEHERE/ATTY. FOR MV.
RESPONSIVE PLEADING

Tentative Ruling

Motion: Dismiss First Amended Complaint
Notice: LBR 9014-1(f)(1); written opposition required
Disposition: Granted with prejudice
Order: Civil minute order

This is the second round in a pleadings dispute between the defendant debtor James Jorgensen ("Jorgensen"), a certified public accountant, and the plaintiffs creditors Donald Aluisi and Karen Aluisi ("Aluisis"), his former clients. Jorgensen moves under Rule 12(b)(6) to dismiss both of the Aluisis' claims of non-dischargeable fraud, 11 U.S.C. § 523(a)(2)(A). Aluisis oppose the motion.

As with the original complaint, the central problem with the First Amended Complaint is that it fails to plead sufficient facts that raise Jorgensen's conduct from negligence to fraud and the court will grant the motion without leave to amend.

FACTS

Aluisis were farmers and commercial real estate owners in the greater Fresno area. For approximately 25 years, Jorgensen rendered services to Aluisis. Those services included financial and tax advice, as well as tax preparation.

In short, the First Amended Complaint ("FAC"), June 13, 2019, ECF # 31, pleads two distinct sets of facts. The first set of facts arises from Jorgensen's under-reporting of the tax basis for one of Aluisis' commercial properties, which resulted in an excess tax liability to Aluisis. In 2000 Aluisis purchased a commercial property known as "The Trading Post." Starting with Aluisis' 2000

income tax returns, and continuing for approximately 14 years, Jorgensen under-reported the tax basis for The Trading Post on Aluisis' state income tax returns by $862,000. (Jorgensen correctly reported the tax basis for The Trading Post on their federal returns at the higher amount.) This resulted in Aluisis paying more tax than they would have paid, had the depreciation been correctly claimed. Aluisis allege that Jorgensen was aware of the error, failed to inform them of it and, in fact, attempted to cover it up in each subsequent year's filing. Aluisis did not learn of the error until 2017, when Aluisis terminated their professional relationship with Jorgensen and hired a new accountant. As a result, Aluisis lost some of the depreciation deduction that they could have claimed and paid excess taxes of $45,000. Jorgensen billed Aluisis for his tax and/or other services $48,000. After discovering the error, Aluisis amended their returns back as far as 2013 but have been unable to amend tax returns for years further back than 2013 because the time period for doing so has expired.

The second set of facts arises from the sale of "The Trading Post." In 2013, Aluisis were approached by "a serious buyer" for "The Trading Post." FAC ¶ 25. "Plaintiff [Aluisis] and the potential buyer were working on a contract for sale at that time and, as of March 2014 they were under contract. Plaintiff decided to use a 1031 Exchange option to defer the taxes. Plaintiff discussed the proposed transaction with Defendant [Jorgensen] shortly thereafter." *Id.* Thereafter, "Plaintiffs met with Defendant on August 19, 2014, and presented their specific plan, by which they would pay off the debt and use the remaining proceeds, exclusive of approximately $1,000,000, to buy smaller properties. Plaintiff asked Defendant's advice regarding this plan." FAC ¶29. Jorgensen told Aluisis that theirs was a "sound plan" and "gave them no warning about the 'mortgage boot' issue." FAC ¶ 30. A "mortgage boot" is a tax generated in a 1031 exchange when the taxpayer reduces mortgage debt in the purchased property. Aluisis concluded the sale and have generated a tax debt "in excess of $2,000,000." FAC ¶ 32.

PROCEDURE

In 2017, Aluisis brought suit against Jorgensen in state court for professional negligence. Complaint ¶ 11, February 16, 2019, ECF # 1. Discovery commenced and Aluisis have deposed Jorgensen. FAC ¶ 14. That action has not been resolved.

Jorgensen, and his spouse, sought chapter 13 protection on November 13, 2018.

Aluisis commenced this adversary proceeding. The original complaint named both Jorgensen and his spouse as defendants and alleged causes of action under 11 U.S.C. §§ 523(a)(2),(4),(6) and 727(a)(2),(7). The Jorgensens moved to dismiss under Rule 12(b)(6). That motion was granted in part, with and without leave to amend, and was denied in part.

The First Amended Complaint seeks relief only under § 523(a)(2)(A). The plaintiffs' first count seeks relief under two factual theories: (1) misrepresentation as to the appropriate tax basis for The

Trading Post and/or concealment of professional negligence, *i.e.*, under reporting of the tax basis for The Trading Post; and (2) affirmative bad advice, *i.e.*, failing to advise them of the tax consequences of the "mortgage boot" contemplated by their plan. The second count seeks relief under the same theory contained in the second part of the first count. Aluisis contend that Jorgensen made false representations to them as to their plan to sell commercial real estate known as The Trading Post, *i.e.*, that their plan was "solid" and "valid" notwithstanding that he "knew that Plaintiffs would incur tax penalties."

LAW

Rule 12(b)(6)

Under Federal Rule of Civil Procedure 12(b)(6), a party may move to dismiss a complaint for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6), *incorporated by* Fed. R. Bankr. P. 7012(b). "A Rule 12(b)(6) dismissal may be based on either a lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory." *Johnson v. Riverside Healthcare Sys., LP*, 534 F.3d 1116, 1121–22 (9th Cir. 2008); *accord Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001).

In ruling on a Rule 12(b)(6) motion to dismiss, the court accepts all factual allegations as true and construes them, along with all reasonable inferences drawn from them, in the light most favorable to the non-moving party. *Sprewell v. Golden State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001); *Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337–38 (9th Cir. 1996). The court need not, however, accept legal conclusions as true. *Iqbal*, 556 U.S. at 678. "A pleading that offers 'labels and conclusions' or 'a formulaic recitation of the elements of a cause of action will not do.'" *Id.* (quoting *Twombly*, 550 U.S. at 555).

Over the last decade in the sibling cases of *Iqbal* and *Twombly* the Supreme Court has provided added guidance for determining the sufficiency of the facts in a complaint. "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556, 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." *Id.* (citing *Twombly*, 550 U.S. at 556).

Iqbal and *Twombly* requires a step analysis:

> Two-prong approach required: To determine whether a pleading adequately states a plausible claim for relief, a court must first take "note of the elements a plaintiff must plead to state a claim." [*Ashcroft v. Iqbal*, *supra*, 556 US at 675, 129 S.Ct. at 1947; *Burtch v. Milberg Factors, Inc.* (3rd Cir. 2011) 662 F3d 212, 220; *Ebner v. Fresh, Inc.* (9th Cir. 2016) 838 F3d 958, 962, 963]

> *Iqbal*, *supra*, then requires a two-prong analysis: [1] First, conclusory allegations are disregarded (citations omitted); [and 2] Second, "[w]hen there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief." [*Ashcroft v. Iqbal*, *supra*, 556 US at 679, 129 S.Ct. at 1950; *Rodríguez-Reyes v. Molina-Rodríguez* (1st Cir. 2013) 711 F3d 49, 53; ¶ 8:127]

Phillips and Stevenson, *California Practice Guide: Federal Civil Procedure Before Trial, California & 9th Cir Editions.*, Pleadings, General Pleading Requirements § 8:125 (Rutter Group 2019) ("Rutter Group"); see also, *Wagstaffe Practice Guide: Federal Civil Procedure Before Trial*, Attacking the Pleadings, Motions to Dismiss 23.75-75.2 (Matthew Bender & Company, Inc. 2019).

"Whether a complaint states a plausible claim for relief is 'a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.' [*Ashcroft v. Iqbal*, supra, 556 US at 679, 129 S.Ct. at 1950 (emphasis added); *Ocasio-Hernández v. Fortuño-Burset* (1st Cir. 2011) 640 F3d 1, 16; *Levitt v. Yelp! Inc.* (9th Cir. 2014) 765 F3d 1123, 1135]. Rutter Group at § 8:128.6.

Moreover, Ninth Circuit authority suggests that a plaintiff must plead facts supporting each element of the claim plead. *Johnson v. Riverside Healthcare System*, LP, 534 F3d 1116, 1122 (9th Cir. 2008), (plaintiff must at least "allege sufficient facts to state the elements of … [his or her] claim").

Finally, in this context the court may consider competing explanations for the alleged conduct to determine whether the facts suggest fraud. As one commentator noted:

> **Effect of competing explanations?** Courts have taken various approaches when there are alternate explanations for the charging conduct alleged by plaintiff, including equally plausible alternate explanations that are entirely legal.
>
> **"Obvious alternative explanation":** If all plaintiff has alleged are facts consistent with illegal behavior but there is an "obvious" and legal alternative explanation for the conduct, the facts alleged by plaintiff will not "plausibly establish" the improper purpose. [See *Ashcroft v. Iqbal*, supra, 556 US at 682, 129 S.Ct. at 1951—allegation that plaintiff's arrest was result of unlawful discrimination against Muslim men was not "plausible" in view of more likely explanation for arrest (detention of illegal aliens who had potential connections to those who committed terrorist acts); *Braden v. Wal-Mart Stores, Inc.* (8th Cir. 2009) 588 F3d 585, 597—"An inference pressed by the plaintiff is not plausible if the facts he points to are precisely the result one would expect from

> lawful conduct in which the defendant is known to have engaged"]
>
> . . .
>
> **Compare—more plausible alternative explanation:** If the factual allegations allow the court to draw the "reasonable inference" that defendant is liable for the alleged misconduct, the pleading will survive a motion to dismiss even if there are alternative explanations that are either more plausible or even probable "unless at least one of those competing inferences rises to the level of an 'obvious alternative explanation.'" [*New Jersey Carpenters Health Fund v. Royal Bank of Scotland Group, PLC* (2nd Cir. 2013) 709 F3d 109, 121; *Evergreen Partnering Group, Inc. v. Pactiv Corp.* (1st Cir. 2013) 720 F3d 33, 45—"It is not for the court to decide, at the pleading stage, which inferences are more plausible than other competing inferences"; *Watson Carpet & Floor Covering, Inc. v. Mohawk Industries, Inc.* (6th Cir. 2011) 648 F3d 452, 458—"Ferreting out the most likely reason for the defendants' actions is not appropriate at the pleadings stage"; (citation omitted)
>
> However, determining the plausibility of an inference does not occur in a "vacuum." Instead, "[t]he reasonableness of one explanation for an incident depends, in part, on the strength of competing explanations. (How reasonable is it to infer that it rained last night from the fact that my lawn is wet? It depends, among other things, on whether I own a sprinkler.)" [*16630 Southfield Ltd. Partnership v. Flagstar Bank, F.S.B.* (6th Cir. 2013) 727 F3d 502, 505]

Rutter Group at §§ 8:128.10-128.11, 8:128.17 (emphasis original).

11 U.S.C. § 523(a)(2)(A)

To succeed on a nondischargeability claim under § 523(a)(2)(A), a creditor must establish five elements: "(1) misrepresentation, fraudulent omission or deceptive conduct by the debtor; (2) knowledge of the falsity or deceptiveness of his statement or conduct; (3) an intent to deceive; (4) justifiable reliance by the creditor on the debtor's statement or conduct; and (5) damage to the creditor proximately caused by its reliance on the debtor's statement or conduct." *Turtle Rock Meadows Homeowners Ass'n v. Slyman (In re Slyman)*, 234 F.3d 1081, 1085 (9th Cir. 2000). "The purposes of [§ 523(a)(2)(A)] are to prevent a debtor from retaining the benefits of property obtained by fraudulent means and to ensure that the relief intended for honest debtors does not go to dishonest debtors." *Id.*

Since this is a claim alleging fraud, Rule 9(b) applies. This rule's heightened pleading standard requires a plaintiff to "state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b), *incorporated by* Fed. R. Bankr. P. 7009. A plaintiff

must include the "who, what, when, where, and how" of the fraud. *Vess v. Ciba-Geigy Corp. U.S.A.*, 317 F.3d 1097, 1106 (9th Cir. 2003). Moreover, the reach of Rule 9(b) is broad, extending to all allegations of fraud, including concealment. *Id.* at § 8:15; *Dummar v. Lummis*, 543 F3d 614, 621 (10th Cir. 2008).

DISCUSSION

First Count

2000-2015 Trading Post Depreciation

Aluisis have attempted to plead both misrepresentation and fraudulent omission. FAC # 18.

Aluisis have not stated a claim for misrepresentation because they have not pleaded facts from which the court may infer knowledge of the falsity, *i.e.*, incorrect reporting of the tax basis, or intent to deceive. The court does not consider the following legal conclusions: (1) use of $2,833,335 was "deliberate," FAC # 13; (2) Jorgensen "should have noticed" and "must have known" about the error, FAC ¶ 14; (3) any effort to "cover up his misstatements," FAC # 16; (4) Jorgensen's "manipulation of the tax bases," FAC # 18; (5) Jorgensen "knew of the falsity or deceptiveness" of his statements, FAC # 19; and (6) "intended to deceive" the plaintiffs, FAC # 20.

But the facts surrounding the under-reporting of the depreciation of The Trading Post are sparse. Jorgensen: (1) was an experienced certified public accountant, who completed at least 80 hours of continuing education every two years, FAC # 10; (2) advised Aluisis, and/or their family and entities on "numerous" §§ 1031, 1033 transactions before The Trading Post purchase, FAC # 10; (3) was unable to produce his working papers, FAC # 12; (4) incorrectly claimed a tax basis on Aluisis state income tax returns of $2,833,335, rather than the $3,695,335 claimed on the federal return and carried the error forward in subsequent years, FAC # 14; (5) had been involved in 20-40 1031 Exchanges over his career, FAC # 14; (6) never disclosed his error to Aluisis, FAC ¶¶ 15-16; (7) sought an extension of time to file the 2014 tax return (the year of The Trading Post sale); (8) did not amend the three most recent tax years, as allowed, FAC # 16; and (9) on a date unknown lowered the basis claimed on the federal tax return to match that claimed on the state tax return.

Accepting each of these facts as true, two inferences are possible; Jorgensen (1) simply and unknowingly errored, which gave rise to a malpractice claim or (2) knowingly mispresented the facts to Aluisis. With the exception of the ninth fact, *e.g.*, reduction of the federal tax basis, the facts support an inference of unknowing error and professional negligence. The ninth fact, *i.e.*, reduction of the tax basis on the federal return, could give rise to an inference of knowledge by Jorgensen. But, without the date on which Jorgensen did so, that fact is unavailing. FAC # 16, p. 7, lines 8-9.

Aluisis have also failed to state a claim for fraudulent omission. It is unquestionably true that in some instances the failure to disclose material facts can give rise to a § 523(a)(2)(A) action. *Tallant v. Kaufman (In re Tallant)*, 218 B.R. 58,64-65 (B.A.P 9th Cir. 1998).

As one court observed:

> While often an affirmative misrepresentation is involved, it is clear that an action under § 523(a)(2)(A) can also be prosecuted on the basis of a concealment or fraudulent omission of a material fact. The BAP in *Stennis v. Davis (In re Davis)*, 486 B.R. 182 (Bankr.N.D.Cal.2013), noted that it is "well recognized that silence, or the concealment of a material fact, can be the basis of a false impression which creates a misrepresentation actionable under § 523(a)(2)(A)." *Id.* at 191 (citing *In re Evans*, 181 B.R. 508, 514–15 (Bankr.S.D.Cal.1995)). **"A debtor's failure to disclose material facts constitutes a fraudulent omission under § 523(a)(2)(A) if the debtor was under a duty to disclose and possessed an intent to deceive."** *Id.* (quoting *Haglund v. Daquila (In re Daquila)*, 2011 WL 3300197 (9th Cir. BAP Feb. 28, 2011)). *See also Barns v. Belice (In re Belice)*, 461 B.R. 564, 580 (9th Cir. BAP 2011); *Mandalay Resort Grp. v. Miller (In re Miller)*, 310 B.R. 185, 196 (Bankr.C.D.Cal.2004) ("The concealment or omission of material facts that a party has a duty to disclose can support the nondischargeability of a debt on the grounds of actual fraud.").

In re Tolman, 491 B.R. 138, 151 (Bankr. D. Idaho 2013) (emphasis added).

In the Ninth Circuit, a party's duty to disclose is governed by the Restatement (Second) of Torts § 551. *Apte v. Japra (In re Apte)*, 96 F.3d 1319, 1323-24 (9th Cir. 1996).

Restatement § 551 provides:

> (1) One who fails to disclose to another a fact that he knows may justifiably induce the other to act or refrain from acting in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.
>
> (2) One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated,
>
> **(a) matters known to him that the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them;** and

> (b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading; and
>
> **(c) subsequently acquired information that he knows will make untrue or misleading a previous representation that when made was true or believed to be so;** and
>
> (d) the falsity of a representation not made with the expectation that it would be acted upon, if he subsequently learns that the other is about to act in reliance upon it in a transaction with him; and
>
> (e) facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.

Restatement (Second) of Torts § 551 (1977) (emphasis added).

Jorgensen did have a duty to Alusis to disclose his errors. *Tallant v. Kaufman (In re Tallant)*, 218 B.R. 58,64-65 (B.A.P. 9th Cir. 1998) (involving an attorney). That duty however is limited to "the extent of [the speaker's] knowledge, *Id.* at p. 153, and consistent with *Iqbal* and *Twombly*, the complaint must plead facts showing "an intent to deceive." *Id.* at p. 151. But, as set forth above, Aluisis have failed to plead facts from which the court can infer that Jorgensen knew of the error or intended to deceive Aluisis.

2015 Trading Post 1031 Exchange

This theory fails for at least two reasons. First, Aluisis have affirmatively pleaded that they did **not** rely on Jorgensen's representations in deciding to sell The Trading Post under the terms of their debt step-down plan. That is true because Aluisis did not seek Jorgensen's advice until **after** they were legally obligated to sell The Trading Post. Consider the plaintiff's very specific factual pleading as to timing. "Plaintiff and potential buyer were working on a contract for sale at that time [2013] and, as of March 2014 they were under contract." FAC ¶ 25. But, as pleaded, they did not confer with Jorgensen until five months later. "Plaintiffs [Aluisis] met with Defendant [Jorgensen] on August 19, 2014, and presented their specific plan . . .Plaintiffs asked Defendant's advice regarding this plan." FAC ¶ 29.

As set forth above, Aluisis have not pleaded facts sufficient to demonstrate that Jorgensen knew his advice was inconsistent with applicable tax law or intended to deceive Aluisis. As a consequence, the plaintiffs have not plead sufficient facts to satisfy *Iqbal* and *Twombly*. The motion will be granted.

Second Count

The second claim for relief is duplicative of the first claim for relief, second theory (Jorgensen's advice pertaining to the 2015 1031 Exchange of The Trading Post). Compare, FAC ¶¶ 25-33 with ¶¶ 42 (same legal theory, *i.e.*, § 523(a)(2)(A), same factual basis ¶ 34 incorporating ¶¶ 25-33).

For the reasons set forth in the first count, second theory, the motion will be granted as to the second count as well.

NO LEAVE TO AMEND

Leave to file an amended complaint is frequently given. As one commentator noted:

> **At least once:** FRCP 15(a) severely restricts the court's discretion to dismiss without leave to amend. **Where a more carefully drafted complaint *might* state a claim, a plaintiff *must be given at least one* more chance to amend the complaint before the district court dismisses the action with prejudice.** [*National Council of La Raza v. Chegavske* (9th Cir. 2015) 800 F3d 1032, 1041—"black-letter law" that district court must give at least one chance to amend absent clear showing amendment would be futile; *Davoodi v. Austin Independent School Dist.* (5th Cir. 2014) 755 F3d 307, 310—dismissal after giving plaintiff only one chance to state case "is ordinarily unjustified" (internal quotes omitted)].

Rutter Group ¶ 9:287 (emphasis original and added).

Here, the court will deny leave to amend for three reasons. First, Aluisis have been already given the opportunity to fix pleading insufficiencies. Second, when the court ruled on Jorgensens' first motion to dismiss, it issued a 25-page decision, providing a detailed description of the factual insufficiencies. Civil Minutes, May 23, 2019, ECF # 25. Among the shortcomings cited was the failure to plead facts as to Jorgensen's knowledge of the error. *Id.* at pp. 15, 20. Because these deficiencies continue to exist in the First Amended Complaint, the court believes that Aluisis are unable to provide the court better and/or more facts, from which further pleading might survive challenge. Finally, Aluisis have already had the benefit of discovery in state court on these issues and, as a consequence, the court concludes that no better facts exist from which Aluisis might benefit.

CIVIL MINUTE ORDER

The court shall issue a civil minute order that conforms substantially to the following form:

The defendant James Jorgensen's motion has been presented to the court. Having considered the motion to dismiss, opposition, and reply thereto, if any,

IT IS ORDERED that the motion is granted without leave to amend; and

IT IS FURTHER ORDERED that the First Amended Complaint, June 13, 2019, ECF # 31, is hereby dismissed.