



SO ORDERED.

SIGNED this 10 day of August, 2007.

Dale L. Somers

Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In Re:

JOHN W. PATTERSON,

DEBTOR.

**CASE NO. 05-27015-7
CHAPTER 7**

TROY SELLNER,

PLAINTIFF,

v.

ADV. NO. 06-6025

JOHN W. PATTERSON,

DEFENDANT.

**OPINION DENYING DEFENDANT'S MOTION TO DISMISS FOR FAILURE
TO STATE A CLAIM ON WHICH RELIEF CAN BE GRANTED**

This proceeding is before the Court on the Defendant-Debtor's motion to dismiss for failure to state a claim on which relief can be granted. The Defendant-Debtor appears

by counsel Conrad Miller, Jr., of Laster & Miller of Lenexa, Kansas. The Plaintiff appears by counsel Luke A. Sobba and Karl R. Swartz of Morris, Laing, Evans, Brock & Kennedy, Chartered, of Topeka and Wichita, Kansas, and J. Michael Dady of Dady & Garner, P.A., of Minneapolis, Minnesota. The Court has reviewed the relevant materials and is now ready to rule.

In January 2004, the Plaintiff entered into an agreement with the Debtor's company to help him establish an auto consulting business. The Plaintiff's new business, located in Minnesota, was not successful, and the Plaintiff sued the Debtor in a Minnesota state court. Shortly after the parties reached a settlement, the Debtor filed a Chapter 7 bankruptcy petition before this Court. The Plaintiff then filed a complaint seeking to establish the Debtor owed him a debt based on various misrepresentations and omissions allegedly made in connection with their contract, and claiming that debt should be excepted from discharge under § 523(a)(2)(A) and § 523(a)(6) of the Bankruptcy Code. The Debtor has filed a motion to dismiss the complaint, arguing it fails to state any claim on which relief can be granted.

FACTS

On a motion to dismiss for failure to state a claim for relief, the Court may consider only the contents of the complaint.¹ If matters outside the complaint are presented and not excluded by the Court, the motion must be treated as one for summary

¹See Fed. R. Civ. P. 12(b), made applicable by Fed. R. Bankr. P. 7012(b).

judgment.² The Debtor attached to his motion a copy of the Plaintiff's agreement with the Debtor's business, and the Plaintiff has not complained about the attachment. However, even considering the arguments the Debtor bases on the agreement, the Court concludes the Plaintiff's complaint states a claim for relief, and the Debtor is not entitled to either dismissal or summary judgment.

The Debtor has a company called American Auto Consultants, Inc. ("Consultants"), located in Overland Park, Kansas. In January 2004, on behalf of Consultants, he sold an auto consulting business opportunity to Troy Sellner, whose address was in Mankato, Minnesota. The contract described Consultants as "a professional advisor and consultant in the area of new vehicle purchases." Under their agreement, Sellner was to pay Consultants \$22,500 in return for various materials, supplies, and services, including "comprehensive personal training at [Sellner's] home or office," a computer, automobile rebate information that was to be regularly updated, and new car pricing software. Sellner was also to pay an annual fee of \$700 to continue to receive updated rebate information and pricing software. Consultants was to allow Sellner to use its "New/Used and collectable Vehicle Research and Locating Service" for \$50 per request. Neither the Debtor nor Consultants ever gave Sellner a "public offering statement," as defined by the Minnesota Franchises Act,³ or a "uniform franchise offering

²*Id.*

³Minn. Stat. Ann. §§ 80C.01 through 80C.22 (Thomson/West 2007).

circular,” as defined by the Federal Trade Commission,⁴ about the sale. Sellner’s agreement with Consultants included provisions saying: (1) Sellner understood and agreed the contract would be “governed, enforced and carried out by the laws of the state of Kansas”; (2) Sellner “agrees that [Consultants] or an agent thereof, makes no written or verbal claims, Representations, promises or warranties as to earnings of [Sellner] or existing Consultants. [Sellner] agrees that said earnings are based upon the Consultants individual work habits”; and (3) Sellner “agrees to research all appropriate business licensing for state and local government agencies who may require licenser [*sic*] for new business, home business, etc., and shall not hold [Consultants] responsible for such knowledge.”

In his complaint, Sellner alleges the Debtor made various representations about the business Sellner could operate with Consultants’ help in order to get him to sign a contract with the company. These included assertions (1) about the amount of income Sellner could expect to derive from the business; (2) that Sellner would only need to spend \$800 on advertising to make his business successful; (3) that Consultants would provide a “personal customer service advisor” who would guide him closely and teach him the business; and (4) that Consultants would give Sellner access to a database with an inventory of nearly one million used cars. Sellner complains these assertions were all false or misleading. He says his income was less than the Debtor said it would be, even

⁴See Federal Trade Comm’n, *Disclosure Requirements and Prohibitions Concerning Franchising*, 16 C.F.R. Part 436.

though Sellner spent much more than \$800 on advertising, his service advisor gave him little or no help, and the database Consultants told him to use was one available on the Internet for anyone to use for free.

Sellner alleges that his contract with Consultants constituted a sale of a franchise under the Minnesota Franchises Act, and that the Debtor and Consultants violated that Act by failing to register what they were selling and failing to make certain disclosures in connection with the transaction. Under that Act, such violations would give Sellner the right to rescind the contract, and the Debtor would be jointly and severally liable with Consultants for the violations.

In this proceeding, Sellner claims the Debtor owes him a debt based on fraud, misrepresentations, and omissions in connection with Sellner's contract with Consultants, stating his claim for relief in three counts. Sellner alleges that debt is excepted from discharge by § 523(a)(2)(A) and (a)(6) of the Bankruptcy Code. The Debtor now asks to have Sellner's complaint dismissed for failure to state a claim on which relief can be granted.

DISCUSSION

The Debtor argues Sellner's first two counts must be dismissed because debts arising under the Minnesota Franchises Act cannot be excepted from discharge by either § 523(a)(2)(A) or § 523(a)(6) because state law cannot provide the basis for exceptions to discharge. This is wrong. Almost all debts are created under non-bankruptcy law and most of the time, that law is state law. Federal bankruptcy law controls what debts are

nondischargeable, but non-bankruptcy law determines whether any debt exists in the first place. If non-bankruptcy law does not make a debtor liable on an alleged obligation, bankruptcy law does not except the alleged obligation from discharge. But if the debtor is liable under non-bankruptcy law, bankruptcy law will then determine whether that liability is dischargeable or not. Sellner alleges the Debtor's debt to him arises either from fraud, misrepresentations, or omissions, or from willful and malicious injury to Sellner's person or property. Such allegations state a claim to except the debt from discharge under § 523(a)(2)(A) or § 523(a)(6).

The Debtor also argues Kansas law, not Minnesota law, controls Sellner's transaction with the Debtor and Consultants because their contract said Kansas law would govern it, and because the Debtor lives in Kansas and filed his bankruptcy case here. As the Court explained in denying Sellner's motion for partial summary judgment, however, Minnesota law may govern at least some aspects of the parties' relationship, depending on various factors and considerations.⁵ The contract's choice-of-law provision and the Debtor's residence and choice of bankruptcy forum do not provide grounds to dismiss Sellner's complaint.

Echoing his argument that state law cannot provide a basis for nondischargeability, the Debtor argues Sellner's third count must be dismissed because it alleges violations of the Federal Trade Commission's rules about franchise sales, including its Uniform

⁵See Order Denying Motion to Strike Defendant's Response to Plaintiff's Motion for Summary Judgment, and Denying Plaintiff's Motion For Partial Summary Judgment, Docket No. 67, filed June 4, 2007.

Franchise Offering Circular Guidelines. The Debtor says even federal non-bankruptcy law cannot provide a ground for excepting a debt from discharge. Like his argument about state law, however, this argument is wrong. Sellner can rely on federal non-bankruptcy law to try to establish that the Debtor owes him a debt. If he can succeed in that effort, the resulting debt may be excepted from discharge because the facts proven to establish the liability also establish that the debt arose from fraud or willful and malicious injury, or Sellner may prove additional facts concerning the transaction that show the facts necessary to except the debt from discharge. In any event, the fact Sellner's third count relies on federal non-bankruptcy law does not mean the count fails to state a claim on which relief can be granted in this proceeding.

Finally, the Debtor argues that Sellner's third count does not state fraud allegations with the particularity required by the rules of procedure,⁶ and that the parties' written contract negates any oral false representations or omissions of material fact that might have been made. The Court cannot agree. Sellner alleges the Debtor made representations in specific dollar amounts about the earning capacity of the opportunity Consultants was providing, and failed to disclose the basis for those assertions as required by rules of the Federal Trade Commission. Sellner alleges the Debtor misrepresented the level of assistance Consultants would provide Sellner. Sellner alleges the Debtor provided unrealistic sales projections, exaggerated the future earnings Sellner would be

⁶See Fed. R. Civ. P. 9(b) ("circumstances constituting fraud . . . shall be stated with particularity"); Fed. R. Bankr. P. 7009 (Civil Rule 9 applies in adversary proceedings).

likely to realize, failed to disclose the factual basis for the earnings claims, and fraudulently misled Sellner about the nature of the business opportunity Consultants was providing. Sellner also alleges the Debtor failed to disclose the fact Sellner would need to get an automobile broker's license, and made misrepresentations about the services Consultants would provide, including giving Sellner access to a national dealer database and locating system. The Court believes Sellner's allegations are sufficiently specific to satisfy the procedural pleading rules.

The Court further concludes the disclaimer provisions in the contract do not require Sellner's third count to be dismissed. Both Minnesota and Kansas law allow a party, despite such disclaimers, to try to prove that a fraudulent misrepresentation was used to induce the party to agree to the contract unless the disclaimer directly contradicts the alleged misrepresentation.⁷ As Sellner points out, the first disclaimer is written in the present tense, so it could be read to say that no representations about earnings are being made in the contract and not to disclaim representations that might have been made previously. After a paragraph that says Sellner shall not act as a "broker," the second disclaimer the Debtor relies on says Sellner will investigate any governmental requirements for licensing a "new business, home business, etc." In light of the paragraph that precedes it, the second disclaimer could easily be read not to apply to the automobile broker's license that Sellner alleges the Debtor failed to tell him about and the

⁷See *Commercial Property Investments, Inc., v. Quality Inns Int'l, Inc.*, 938 F.2d 870, 875-76 (8th Cir. 1991) (Minnesota law); *Ramada Franchise Systems, Inc., v. Tresprop, Ltd.*, 188 F.R.D. 610, 613-15 (D. Kan. 1999) (Kansas law).

State of Minnesota required him to obtain. At trial, the disclaimers might help support a finding that Sellner did not justifiably rely on the Debtor's alleged misrepresentations and omissions, but they do not require the dismissal of Sellner's third count at this early stage in this proceeding.

CONCLUSION

For these reasons, the Court concludes the Debtor's motion to dismiss must be denied.

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