U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS

ENTERED

TAWANA C. MARSHALL, CLERK
THE DATE OF ENTRY IS
ON THE COURT'S DOCKET

The following constitutes the order of the Court.

Signed September 10, 2004.

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
WESTERN NATURAL GAS, L.L.C.,	§	CASE NO. 01-36710-SAF-7
DEBTOR(S).	§	
	§	
SCOTT M. SEIDEL, CHAPTER 7	§	
TRUSTEE,	§	
PLAINTIFF,	§	
	§	
VS.	§	ADVERSARY NO. 03-3630
	§	
DENNIS G. McLAUGHLIN, III,	§	
et al.,	§	
DEFENDANTS.	§	

MEMORANDUM OPINION AND ORDER

Defendant Dennis G. McLaughlin, III, moves the court, under Fed. R. Civ. P. 8 and 12(b)(6), made applicable by Bankruptcy Rules 7008 and 7012, to dismiss the first amended complaint filed by Scott M. Seidel, the Chapter 7 trustee of the bankruptcy estate of Western Natural Gas, L.L.C., the debtor. Seidel opposes the motion. The court conducted a hearing on the motion on August 25, 2004.

This is the second go round for McLaughlin to launch a Rule 12(b)(6) attack on Seidel’s complaint. By order entered July 9, 2004, the court dismissed Seidel’s original complaint with leave to replead. On July 21, 2004, Seidel filed his first amended complaint. McLaughlin contends that Seidel still has failed to state a claim upon which relief can be granted.

In the first amended complaint, Seidel alleges that McLaughlin had been the manager as well as a director and the controlling shareholder of the debtor, a Delaware limited liability company. Seidel alleges that McLaughlin caused the debtor to make transfers within the bankruptcy preference period and to make other transfers to insiders within forty-eight months of the bankruptcy petition. Seidel contends that these transfers demonstrate a conscious indifference to the rights of the debtor’s creditors. In addition, Seidel alleges that McLaughlin caused the debtor to advance loans to insiders, including an affiliated entity controlled by McLaughlin. Seidel contends that the transactions demonstrate a conflict of interest and result in a breach of McLaughlin’s fiduciary duty to the debtor and its creditors. Seidel alleges that the debtor had been in a zone of insolvency when all these transfer had been made, resulting in a breach of a fiduciary duty by McLaughlin to the debtor’s creditors.

Seidel further alleges that McLaughlin mismanaged the debtor’s business of buying and selling natural gas by not protecting the debtor against natural gas price fluctuations. Seidel contends that McLaughlin’s management of the debtor’s business created a worsening insolvency, increasing the debtor’s obligations from $4,000,000 in 2000 to $18,000,000 in 2001. Seidel alleges that McLaughlin caused the debtor to sell fixed price contracts without compensating or protecting the debtor from the resulting exposure, thereby increasing the risks to the debtor’s business. Seidel also contends that McLaughlin’s management resulted in negligence, gross negligence and a breach of McLaughlin’s fiduciary duty to the debtor and its creditors.

On these allegations, Seidel asserts five counts: (1) breach of trust fund duties; (2) breach of fiduciary duties; (3) negligence and gross negligence; (4) exemplary damages; and (5) attorney’s fees. McLaughlin moves to strike all five counts under Rules 8 and 12(b)(6).

As stated in the memorandum opinion accompanying the order entered on July 9, 2004, Rule 8(a) requires that a pleading alleging a claim for relief contain “a short and plain statement of the claim showing that the pleader is entitled to relief.” Rule 12(b)(6) permits a defendant to move to dismiss a pleading for failure to state a claim upon which relief may be granted. The court must determine, in the light most favorable to the plaintiff, whether the complaint states any valid claim for relief. Cinel v. Connick, 15 F.3d 1338 (5th Cir. 1994). A complaint may not be dismissed for failure to state a claim "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Conley v. Gibson, 355 U.S. 41, 45-46 (1957). The court must accept as true all well-pleaded allegations contained in the plaintiff's complaint. Albright v. Oliver, 510 U.S. 266, 268 (1994). The facts pled must be specific, however, and not merely conclusory. Guidry v. Bank of La Place, 954 F.2d 278, 281 (5th Cir. 1992).

Count One: Breach of Trust Fund Duties

In this count, Seidel seeks to recover damages from McLaughlin caused by McLaughlin's alleged breach of his duties to the debtor's creditors stemming from the application of the so-called trust fund doctrines. Seidel does not contend that McLaughlin received assets from the debtor which he can recover under the trust fund doctrines. Rather, he asserts that the court should impose the duties on McLaughlin that exist under the trust fund doctrines and then assess damages against McLaughlin for the breach of those duties. In effect, Seidel invokes the trust fund doctrine to establish the fiduciary duty to creditors that Seidel pursues in count two. Count one must be read in that context, as plead.

Seidel alleges that while insolvent, the debtor had "ceased doing business in good faith," resulting in the application of the Texas trust fund doctrine. Alternatively, Seidel argues that the Delaware law applies, as the debtor was a Delaware limited liability company.

As discussed in the court's memorandum opinion of July 9, 2004, Texas law imposes fiduciary duties on an officer and/or director of a corporation, which include duties of care, obedience and loyalty. Gearhart Indus., Inc. v. Smith Int'l, Inc., 741 F.2d 707, 719-21 (5th Cir. 1984). In addition, the directors have a minimum "duty and responsibility to protect the corporation against acts adverse to the interest of the corporation, whether perpetrated by fellow directors or by strangers to the corporation." Int'l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 580 (Tex. 1963).

For a solvent corporation, the duty applies to the corporation and its shareholders. Upon insolvency, the fiduciary duty owed to the shareholders may shift to the creditors. Under the Texas trust fund doctrine, "when a corporation (1) becomes insolvent and (2) ceases doing business . . . [t]he officers and directors hold the corporate assets in trust for the corporate creditors." Hixson v. Pride of Texas Distrib. Co., Inc., 683 S.W.2d 173, 176 (Tex. App.–-Fort Worth 1985, no writ).

Seidel alleges that the debtor had been insolvent and that the debtor had "ceased doing business in good faith." Texas law requires that the debtor cease doing business. Indeed, traditionally, courts impose the doctrine when a corporation is being dissolved. Fagan v. La Gloria Oil & Gas Co., 494 S.W.2d 624, 629 (Tex. Civ. App. 1973). Seidel alleges an altogether different fact, namely, that the debtor had ceased doing business in good faith. Seidel's pleading concedes that the debtor had not ceased doing business as required by the Texas cases. Therefore, Seidel cannot invoke the Texas doctrine to shift McLaughlin's fiduciary duty from the debtor and its shareholders to the debtor and its creditors.

McLaughlin argues that the Texas trust fund doctrine permits recovery of assets distributed among a corporation's officers, directors and shareholders or when the assets are traceable to a third person who is not a bona fide purchaser. See Hunter v. Forth Worth Capital Corp., 620 S.W.2d 547, 550 (Tex. 1981). As Seidel does not allege a transfer of assets to McLaughlin himself, McLaughlin argues that the doctrine does not apply.

McLaughlin confuses an effort by Seidel to recovery property as trust fund property with an effort by Seidel to establish that McLaughlin breached the duties that run to creditors as a result of the doctrine. As observed above, in count one, Seidel does not invoke the trust fund under either Texas or Delaware law to recover assets transferred to McLaughlin or traceable to third persons who are not bona fide purchasers. Rather, he invokes the doctrine to establish the fiduciary duty to creditors. Nevertheless, Seidel has not stated a claim for relief under the Texas trust fund doctrine, because Seidel cannot establish the elements for the application of the Texas doctrine.

Delaware takes a different approach. In Delaware, when a debtor enters a zone or vicinity of insolvency, the fiduciary duties owed by an officer and director of the corporation to the corporation and its shareholders shifts to the corporation and its creditors. Greyer v. Ingersoll Publications Co., 621 A.2d 784, 790-91 (Del. Ch. 1992). Based on the allegations of the complaint, the court cannot conclude that Seidel cannot prove a set of facts that would trigger the duty to creditors under Delaware law.

McLaughlin complains that Seidel has not alleged when the debtor became insolvent. Seidel has alleged that the debtor was insolvent, that the debtor made transfers while insolvent, that McLaughlin managed the debtor’s business while in a zone of insolvency and that the debtor’s insolvency became worse while McLaughlin managed the business. These pleadings meet the notice requirements of Rule 8. The court cannot find that Seidel cannot prove a set of facts that the debtor was insolvent or in a zone or vicinity of insolvent during the relevant times of the challenged McLaughlin actions.

Therefore, the court will grant the motion to dismiss count one to the extent that it alleges a breach of Texas trust fund duties but deny the motion to the extent count one alleges a breach of Delaware law.

Count Two: Breach of Fiduciary Duties

As discussed above, the court cannot find that Seidel cannot prove a set of facts that McLaughlin breached a fiduciary duty to the debtor and/or its creditors, with the duty premised on Delaware law.

McLaughlin nevertheless argues that Seidel premises his breach of fiduciary duty claim on alleged fraudulent transfers. Seidel stipulates that he does not assert a claim for fraud or to avoid and recover fraudulent transfers. To eliminate any uncertainty or ambiguity, to the extent that the complaint can be read to allege a claim of fraudulent transfer, that claim will be dismissed. Seidel may, however, allege facts as part of his allegations of a breach of fiduciary duty that might be construed as meeting the elements of a fraudulent transfer without alleging a claim to avoid any transfer.

McLaughlin contends that Seidel may not pursue this count because of an exculpation clause in the debtor’s Amended and Restated Limited Liability Company Agreement, referred to as the Western Agreement. Seidel has not made the Western Agreement part of his complaint. While Seidel refers to McLaughlin’s position with the debtor and while the Western Agreement may define that position, Seidel neither expressly references the agreement in the complaint nor attaches the agreement to the complaint. Also, Seidel's claim for breach of fiduciary duties exist and may be established by evidence independently of the agreement.

McLaughlin premises his exculpation argument, therefore, on a matter outside the complaint. The court has discretion to consider a matter, of which it may take judicial notice, outside the complaint. See Lovelace v. Software Spectrum, Inc., 78 F.3d 1015, 1018 (5th Cir. 1996). On a Rule 12(b)(6) motion, if matters outside the pleading are presented to and not excluded by the court, then the motion must be treated as a motion for summary judgment and addressed under Rule 56. The parties must be given a reasonable opportunity to present material made pertinent if the motion is treated under Rule 56. That requires the court to afford the non-moving party with the procedural safeguards of Rule 56. Southmark v. Riddle (In re Southmark), 138 B.R. 820, 822 (Bankr. N.D. Tex. 1992). The court will not consider the Western Agreement on a Rule 12(b)(6) motion. McLaughlin has plead his exculpation theory as an affirmative defense and the court will consider it when raised by summary judgment or at trial.

The court will therefore deny the motion to dismiss count two.

Count Three: Negligence and Gross Negligence

McLaughlin moves to dismiss the negligence count based on the exculpation clause of the Western Agreement. For the reasons stated above, the court will deny the motion.

McLaughlin moves to dismiss the gross negligence count contending that Seidel's allegations cannot meet the elements of gross negligence. As stated in the memorandum opinion of July 9, 2004, gross negligence is defined under Texas law as an entire want of care that would raise the belief that the act or omission complained of was the result of a conscious indifference to the rights or welfare of the person affected by it. Jones v. Texaco, Inc., 945 F.Supp. 1037, 1048 (S.D. Tex. 1996)(citing Burk Royalty Co. v. Walls, 616 S.W.2d 911, 920 (Tex. 1981)). McLaughlin argues that Texas courts apply a subjective and an objective test to determine whether a defendant has acted in a conscious indifference to the rights or welfare of another. Transportation Ins. Co. v. Moriel, 879 S.W.2d 10, 22 (Tex. 1994). In Moriel, an injured worker brought suit against a workers' compensation carrier, alleging bad faith delay in paying medical bills. Addressing the issue of whether the gross negligence of a party justified exemplary damages, the court applied a definition of gross negligence which included two elements:

> (1) viewed objectively from the standpoint of the actor, the act or omission must involve an extreme

> degree of risk, considering the probability and magnitude of the potential harm to others, and (2) the actor must have actual, subjective awareness of the risk involved, but nevertheless proceed in conscious indifference to the rights, safety, or welfare of others.

879 S.W.2d 10 at 23. The court in Moriel refused to grant punitive damages because the record contained neither legally sufficient, conclusive evidence of the defendant's subjective, conscious indifference towards its acts under the gross negligence theory nor an objective inference that the defendant's actions created any risk of serious harm to the plaintiff. 879 S.W.2d 10 at 25. In its analysis of the subjective element, the court required that the defendant was "actually aware of an extreme risk - some genuine and unjustifiable likelihood of serious harm . . . that was independent and qualitatively different." 879 S.W.2d 10 at 25-26.

Seidel responds that conscious indifference under either approach may be established by circumstantial evidence. Moriel, 879 S.W.2d 10 at 23. Construing the allegations of the entire complaint in the light must favorable to Seidel, the court cannot conclude that Seidel cannot prove a set of fact that McLaughlin managed the debtor's business with an actual awareness of and knowledge of the risk to the debtor, which could amount to recklessness. The court also cannot conclude that Seidel cannot establish an indifference to creditors by incurring that risk with the alleged resulting increased debt exposure to the debtor.

In short, the court cannot conclude that Seidel cannot prove a set of facts to establish his claim of gross negligence. The court will deny McLaughlin's motion to dismiss count three.

Count Four: Exemplary Damages

Contending that the count for gross negligence must be dismissed, McLaughlin argues that the count for exemplary damages must also be dismissed. Texas law permits recovery of punitive damages for gross negligence. Tex. Civ. Prac. & Rem. Code § 41.003 (2003) ("[E]xemplary damages may be awarded only if the claimant proves by clear and convincing evidence that the harm with respect to which the claimant seeks recovery of exemplary damages results from: (1) fraud; (2) malice; or (3) gross negligence"). Seidel alleges a claim of gross negligence. Seidel concedes that he does not allege a claim for fraud. Since the motion to dismiss the gross negligence claim under Rule 12(b)(6) will be denied, the court will also deny the motion to dismiss this count. Whether Seidel may recover exemplary damages cannot be determined until the gross negligence claim is determined.

Count Five: Attorney's Fees

McLaughlin contends that Seidel has not alleged a basis to recover attorney's fees under Texas law. Under Texas law, attorney's fees may be recovered on certain claims, namely if the claim is for "(1) rendered services; (2) performed labor; (3)

furnished material; (4) freight or express overcharges; (5) lost or damaged freight or express; (6) killed or injured stock; (7) a sworn account; or (8) an oral or written contract." Tex. Civ. Prac. & Rem. Code § 38.001 (1997). As Seidel has not alleged a claim under any of these causes of action, he may not recover attorney's fees as such.

Seidel argues, however, that attorney's fees may be awarded as a component of exemplary damages, citing Gannett Outdoor CO. of Texas v. Kubeczka, 710 S.W.2d 79, 90 (Tex. App. 1986). To the extent that attorney's fees may be included as exemplary damages, Seidel must pursue them under count four of the first amended complaint, and not as a separate count. The court will therefore grant McLaughlin's motion to dismiss count five.

Other Issues

As discussed above, Seidel has alleged facts that arguably could give rise to a fraudulent avoidance cause of action. Seidel concedes that he has not alleged a count for the avoidance of any fraudulent transfer. Seidel has also not alleged claims for fraud, tortious interference with contracts or constructive trust. To the extent that the complaint may be construed as allegedly one of those claims, it will be dismissed.

Order

Based on the foregoing,

IT IS ORDERED that the motion to dismiss is **GRANTED IN PART**

and **DENIED IN PART**.

IT IS FURTHER ORDERED that count one to the extent it alleges a claim based on the Texas trust fund doctrine and count five are dismissed. Count five is dismissed without prejudice to Seidel's claim that attorney's fees may be included as exemplary damages under count four.

IT IS FURTHER ORDERED that any claim for fraud, tortious interference with contracts, constructive trust and avoidance of a fraudulent transfer is dismissed.

IT IS FURTHER ORDERED that in all other respects the motion to dismiss is denied.

###END OF ORDER###