2002 BNH 033 Note: This is an unreported opinion. Refer to AO 1050-1 regarding citation.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re
Catherine Lawson Michel
Debtor

Bk. No. 01-12121-MWV
Chapter 7

UmbrellaBank, FSB
Plaintiff

v.

Adv. No. 01-1171-MWV

Catherine Lawson Michel and
Victor W. Dahar, Trustee,
Defendants

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MEMORANDUM OPINION

The Court has before it UmbrellaBank's (Plaintiff's)[1] Motion to Dismiss the First Counterclaim of Catherine Lawson Michel ("Motion").[2] At a hearing held May 14, 2002, the Court heard the parties and thereafter took the matter under submission. Based upon the record before it and for the reasons set out below, the Court grants the Plaintiff's Motion. The Court has previously issued an order, dated

[1] Formerly Argo Federal Savings Bank, F.S.B, n/k/a UmbrellaBank, F.S.B.

[2] Unless otherwise noted, all statutory section references herein are to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 101, *et seq.*

October 21, 2002, consistent with this opinion.

JURISDICTION

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

FACTS

Catherine Lawson Michel ("Defendant"/"Debtor") incurred a debt with the Plaintiff under a Promissory Note, dated December 21, 1999, executed by the Debtor and her then spouse, Robert Michel, in the principal amount of $500,000 ("Promissory Note") and secured by a Stock Pledge and Security Agreement of the same date ("Stock Pledge Agreement").[3] See Adv. Doc. 8, Answer to Complaint, ¶¶

[3] The Stock Pledge Agreement provides, in part:

> (¶ 2) Grant of Security. ... Grantor agrees to deliver and pledge at all times under this security agreement stock interest having a market value equal to or in excess of 200% of the outstanding balance of the note ....
> (¶ 4) Certificates. If, while this Agreement is in effect, Grantor shall become entitled to receive or shall receive any certificate representing his stock interests in Corporation, or any part thereof, Grantor for himself, agrees to accept the same as agent for Lender and to deliver the same forthwith to the Lender in the exact form received, with the endorsement of the Grantor when necessary and/or appropriate with undated powers unduly executed in blank, in form and substance satisfactory to the Lender, subject to terms hereof, as additional Collateral.
> (¶5) Representations and Warranties. ... The delivery to Lender of the stock certificates evidencing ownership of the Stock Interests shall protect Lender's security interest in the Collateral... .
> (¶14) Lender's Duties. The Powers conferred on Lender hereunder are solely to protect its interest in the Collateral and shall not impose any duty upon it to exercise any such powers. Except for the safe custody of any Collateral in its possession and the accounting for monies actually received by it hereunder, Lender shall have no duty as to any Collateral or as to the taking of any necessary steps to preserve rights against prior parties or any other rights pertaining to any Collateral Lender shall be deemed to have exercised reasonable care in the custody and preservation of the Collateral in its

38, 39. Under the Stock Pledge Agreement, the Debtor and her former spouse pledged 464,584 shares of e-Ventures Common Stock ("Stock") as collateral.[4] See id. After the execution of the Promissory Note and Stock Pledge Agreement, the Michels requested the return of the stock certificate in order to sell 200,000 shares and the Plaintiff cooperated. However, the Plaintiff allegedly never realized any of the proceeds from the sale of 264,584 shares of the Stock. The Defendant subsequently defaulted on the Promissory Note on February 1, 2001.

The Plaintiff filed suit against the Defendant and Robert Michel in the United States District Court for the Northern District of Illinois, Eastern Division on May 16, 2001, seeking recovery under the Promissory Note and alleging bank fraud. Prior to the entry of a judgment in the case, the Defendant filed for bankruptcy protection under Chapter 7 of the Code on June 22, 2001, staying the Illinois proceeding. On Schedule D of her petition, she lists the Plaintiff as holding a claim in the amount of $516,856.21, of which $481,856.21 is unsecured.

On September 21, 2001, the Plaintiff filed the instant nondischargeability complaint pursuant to sections 523(a)(2), (4), and (6) (the "Complaint"). In her answer to the Complaint, captioned "Answer to the Complaint, Counterclaims and Affirmative Defenses," the Defendant raised the following causes of action against the Plaintiff: breach of fiduciary duty, breach of common law duty of good faith and fair dealing, breach of a duty to exercise "the same degree of care, diligence and prudence as a reasonably competent, commercial lender would have exercised" and negligence in the exercise of the alleged duty (collectively the "First Counterclaim"). Adv. Doc. 8, ¶¶ 59-67. The Defendant contends that, because the Plaintiff failed to sell the remaining Stocks it held as collateral, the Plaintiff breached several duties it

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> possession if such Collateral is accorded treatment substantially equal to that which Lender accords to its own property....
>
> Adv. Doc. 1, Ex. B.

[4] The Defendant alleges that she had no interest in the Stock "until June 7, 2000, when Robert Michel assigned or transferred 222,292 shares of it to her per obligation of a pending divorce settlement." Adv. Doc. 8 at ¶ 7.

allegedly owed to the Defendant and caused the Defendant "unnecessary harm, damage and loss[,]" as the remaining Stock's value diminished from a "sudden decline in the telecom sector." Id. In its Motion, the Plaintiff seeks dismissal of all causes of action in the Defendant's First Counterclaim. Adv. Doc. 24, Motion to Dismiss.

DISCUSSION

In ruling on a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), made applicable to bankruptcy proceedings by Federal Rule of Bankruptcy Procedure 7012, the Court shall "construe the complaint liberally and treat all well-pleaded facts as true, according the plaintiff the benefit of all reasonable inferences." Murphy v. United States, 45 F.3d 520, 522 (1st Cir. 1995). The Court must also determine whether the complaint "contains any facts sufficient to justify recovery on any cognizable theory." LaChapelle v. Berkshire Life Ins. Co., 142 F.3d 507, 508 (1st Cir. 1998). In arriving at this determination, "the Court's role is not to weigh the merits of the ... allegations, but rather to simply determine if sufficient facts are plead showing that the [party] is entitled to relief." In re R & R Assocs. of Hampton, 248 B.R. 1, 4 (Bankr. D.N.H. 2000). The Court must "differentiate between well-pleaded facts, on the one hand, and 'bald assertions, unsupportable conclusions, periphrastic circumlocution, and the like,' on the other hand; the former must be credited, but the latter can safely be ignored." LaChapelle, 142 F.3d at 508 (quoting Aulson v. Blanchard, 83 F.3d 1, 3 (1st Cir. 1996)).

A. Choice-of-Law

In the instant case, the parties dispute which state's law applies, the law of Illinois or Nevada. In the bankruptcy context, courts disagree as to which choice-of-law rules should be applied. Some courts have concluded that bankruptcy courts should apply federal choice-of-law rules, which incorporate the Restatement (Second) of Conflict of Laws ("Second Restatement"). See e.g. Liberty Tool, & Mfg. v. Vortex Fishing Sys., Inc. (In re Vortex Fishing Sys., Inc.), 277 F.3d 1057, 1069-70 (9th Cir. 2002);

Lindsay v. Beneficial Reinsurance Co. (In re Lindsay), 59 F.3d 942, 948 (9th Cir. 1995), cert. denied, 516 U.S. 1074, 116 S. Ct. 778, 133 L. Ed. 2d 730 (1996) ("In federal question cases with exclusive jurisdiction in federal court, such as bankruptcy, the court should apply federal, not forum state, choice of law rules"). While others, where state law questions arise in bankruptcy proceedings, have applied the choice-of-law rules of the forum state, pursuant to Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). See e.g. Bianco v. Erkins (In re Gaston & Snow), 243 F.3d 599, 605-607 (2d Cir. 2001) (holding, where case does not implicate important federal bankruptcy policy, bankruptcy court considering state law claims should apply the choice-of-law principles of the forum state, rather than federal choice-of-law rules); Compliance Marine, Inc. v. Campbell (In re Merritt Dredging Co.), 839 F.2d. 203 (4th Cir. 1988). This Court, however, need not make a determination as to the merits of the two approaches because whether the Court applies federal or forum state (New Hampshire) choice-of-law principles the result is the same: the law of Illinois governs the instant matter.

Paragraph 14 of the Promissory Note and paragraph 25 of the Stock Pledge Agreement contain choice-of-law provisions designating Illinois law as the governing law of the transaction.[5] See Restatement (Second) of Conflict of Laws § 187(1) (1971) (where the parties have designated the law of a particular state "to govern their contractual rights and duties," such a choice of law provision will apply if the issue is "one which the parties could have resolved by an explicit provision in their agreement directed to that issue."); Allied Adjustment Serv. v. Heney, 125 N.H. 698, 700, 484 A.2d 1189, 1191 (N.H. 1984) (finding that "where parties to a contract select law of a particular jurisdiction to govern their affairs, that choice will be honored if the contract bears any significant relationship to that jurisdiction"). Under both the Second Restatement and New Hampshire law, such a choice-of-law provision will be

[5] The Promissory Note provides that "the validity and interpretation of this note shall be governed under the laws of Illinois." Adv. Doc. 1, Ex. A at 5. The Stock Purchase Agreement states that "[t]his Agreement shall be governed by and construed in accordance with the laws of the State of Illinois." See id., Ex. B at ¶ 25.

enforced if the forum chosen has a significant relationship to the contract. See id.; see also Rest. 2d § 187(2)[6].

The Defendant does not dispute that she executed the Promissory Note and Stock Pledge Agreement. See Adv. Doc. 8, ¶¶ 6, 7, and 38. The selected jurisdiction of the parties, Illinois, has a significant relationship to the contract because it is the principal place of business of the Plaintiff. Further, the allegations of breach of fiduciary duty, breach of common law duty of good faith and fair dealing, negligence and negligent misrepresentation are duty-based claims and the duties alleged all arise from the Promissory Note and Stock Pledge Agreement. Accordingly, since the counts are dependent upon the Promissory Note and Stock Pledge Agreement, Illinois law governs the relationship of the parties in the present case.

B. Breach of Fiduciary Duty

In paragraph 61 of the First Counterclaim, the Defendant alleges that the Plaintiff "acted in a fiduciary or quasi-fiduciary capacity with respect to the Defendant ... and owed her the duties of candor, care, due diligence and loyalty." Adv. Doc. 8, ¶ 61. Under Illinois law, there is "nothing inherent in business dealings between lender and borrower from which springs a cognizable fiduciary relationship in the absence of facts or circumstances pleaded from which such a connection may be inferred." See McErlean v. Union Nat'l Bank of Chicago, 90 Ill. App. 3d 1141, 1148-49, 414 N.E.2d 128, 134 (Ill. App. Ct. 1980). The party alleging the existence of such a relationship must plead sufficient facts to

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[6] Rest. 2d § 187(2) provides:

> The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either:
>
> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Rest. 2d § 187(2).

demonstrate that the course of dealing between the lender and borrower went beyond the typical borrower relationship. Teachers Ins. & Annuity Ass'n of America v. LaSalle Nat'l Bank, 295 Ill. App. 3d 61, 71, 691 N.E.2d 881, 888-889 (Ill. App. Ct. 1998).

In the present case, the Defendant did not allege any facts or circumstances from which the Court could conclude the existence of some special fiduciary, or quasi-fiduciary, relationship between this borrower and this lender. Although the Defendant alleged that the Plaintiff "held itself out to be a competent, experienced commercial lender having the special expertise necessary to make significant loans secured by restricted securities," nowhere did she allege that the course of dealings between them created a special connection that would create a fiduciary duty on the part of the Plaintiff. Adv. Doc. 8, ¶¶ 34, 60; see also Bank Computer Network Corp. v. Continental Illinois Nat'l Bank & Trust Co. of Chicago, 110 Ill. App. 3d 492, 503, 442 N.E.2d 586, 594 (Ill. App. Ct. 1982) (plaintiff's contention that it gave defendant lender confidential information and placed trust and confidence in lender not sufficient to create fiduciary duty). Accordingly, since the Defendant did not plead sufficient facts to demonstrate that she is entitled to relief, her First Counterclaim for breach of fiduciary duty is dismissed.

C. Breach of Duty of Good Faith and Fair Dealing

In paragraph 62 of the First Counterclaim, the Defendant alleges that the Plaintiff owed her a common law duty of good faith and fair dealing and that "the Plaintiff had a duty and obligation to exercise the same degree of care, diligence and prudence as a reasonably competent commercial lender would have exercised to protect its own interests and those of the Defendant under the same or similar circumstances." Adv. Doc. 8, ¶ 62. Although there is a contract cause of action for breach of implied covenant of good faith and fair dealing under Illinois law, there is no independent tort cause of action of bad faith in the context of a lender/borrower relationship. See Voyles v. Sandia Mortgage Corp., 196 Ill. 2d 288, 295-296, 751 N.E.2d 1126, 1130-31 (Ill. 2001) (declining to recognize an independent tort cause of action for bad faith outside of the employment and insurance contexts); Cramer v. Ins. Exch. Agency,

174 Ill.2d 513, 221 Ill.Dec. 473, 675 N.E.2d 897 (Ill. 1996) (determining that the covenant of good faith and fair dealing implicit in all contracts is not generally recognized as an independent source of duties giving rise to a cause of action in tort); Bass v. SMG, Inc., 328 Ill. App. 3d. 492, 504, 765 N.E.2d 1079, 1090 (Ill App. Ct. 2002) (noting that Illinois recognizes a "covenant of good faith and fair dealing" in every contract as a matter of law, absent an express disavowal, and that, despite plaintiff's effort to characterize his allegations in tort they arise out of the rights, obligations and expectancies created by an arbitration agreement and act as substitutes for a contract claim which would have encompassed the behavior alleged in all of his tort claims).

Additionally, in her response to the Motion, the Defendant incorporates an allegation of breach of the duty of good faith and fair dealing under the Illinois Uniform Commercial Code ("IUCC"). However, the Defendant did not plead such a claim in her First Counterclaim and, thus, the IUCC claims will not be considered by the Court.

D. Negligence and Negligent Misrepresentation

The Defendant alleges that the Plaintiff "knew or should have known that the Defendant would reasonably rely on the Plaintiff's material misrepresentations regarding its special expertise" and that the Plaintiff's "acts and omissions were the proximate cause of its own losses and also caused ... the Defendant to sustain additional unnecessary harm, damage and loss." Adv. Doc. 8, ¶¶ 63, 66. In connection with these allegations the Defendant notes that the "Defendant's loss resulted from the precipitous, sudden decline in the telecom sector of the economy coupled with the Plaintiff's negligent misrepresentations regarding its familiarity with and ability to deal with restricted securities as collateral." Adv. Doc. 28, Defendant's Memo. of Law in Support of Objection, 10. Such claims, however, are barred by the economic loss doctrine, which prohibits tort recovery for purely economic damages. Moorman Mfg. Co. v. National Tank Co., 91 Ill. 2d 69, 88, 435 N.E.2d 443, 451-52 (Ill. 1982). Moreover, neither claim falls into one of the three exceptions to the economic loss rule:

> (1) the plaintiff has sustained a personal injury or property damage as a result of a sudden or dangerous occurrence; (2) the plaintiff's damages are proximately caused by the defendant's intentional, false misrepresentation; or (3) the plaintiff's damages are proximately caused by a negligent misrepresentation made by a defendant in the business of supplying information for the guidance of others in their business transactions.

Mars, Inc. v. Heritage Builders, Inc., 327 Ill. App. 3d 346, 351-52, 763 N.E.2d 428, 434 (Ill. App. Ct. 2002).

In the instant case, the Defendant has failed to allege a personal injury or property damage. See id. at 351, 763 N.E.2d at 434. Although the Defendant alleges she was harmed by the loss of value of the Stock held by the Plaintiff, there was no allegation that damage occurred to property other than the Stock's value. See id. Accordingly, the first exception is not applicable. The Defendant's claims also do not fit within the second exception to the economic loss doctrine as she has failed to allege that any damages were caused by the Plaintiff's "intentional false representations." See id. Lastly, the third exception does not apply because the Defendant has not alleged that the Plaintiff is "in the business of supplying information for the guidance of others in their business transactions." Id. at 351-52, 763 N.E.2d at 434.

CONCLUSION

For the reasons outlined above, the Plaintiff's Motion is granted. This opinion constitutes the Court's findings and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

DATED this 24th day of October, 2002, at Manchester, New Hampshire.

/s/ Mark W. Vaughn
Mark W. Vaughn
Chief Judge