IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:	)	CASE NO. BK02-82433
	)	
BRADLEY KENT YOST and ROXIE LEE YOST,	)	A02-8104
	)	CH. 7
Debtor(s).	)	
COMMERCIAL STATE BANK,	)	
Plaintiff,	)	
vs.	)	
BRADLEY KENT YOST,	)	
Defendant.	)	

MEMORANDUM

Trial was held in Omaha, Nebraska on March 5, 2004, before a United States Bankruptcy Judge for the District of Nebraska on a complaint to object or to revoke a discharge filed by Commercial State Bank. Richard Hoch appeared for the plaintiff and Bruce Barnhart appeared for the debtor/defendant. This memorandum contains findings of fact and conclusions of law required by Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(I).

The debtor, prior to filing this Chapter 7 bankruptcy case, was in the construction business for several years. The plaintiff, Commercial State Bank, provided some financing for the construction projects. On the date the bankruptcy petition was filed, the debtor still owed the bank approximately $72,000 on three separate promissory notes. The bank filed this adversary proceeding, which was tried on the basis that 11 U.S.C. § 523(a)(2)(A) and (B) applied. Those statutory sections provide that a debtor shall not receive a discharge from any debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by –

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing –

(i) that is materially false;
(ii) respecting the debtor's or an insider's financial condition;
(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
(iv) that the debtor caused to be made or published with intent to deceive[.]

11 U.S.C. § 523(a)(2).

For a debt to be declared nondischargeable under § 523(a)(2)(A) for fraud or false representation, the creditor must show, by a preponderance of the evidence, that: (1) the debtor made a representation; (2) the representation was made at a time when the debtor knew the representation was false; (3) the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the creditor; (4) the creditor justifiably relied on such representation; and (5) the creditor sustained a loss as the proximate result of the representation having been made. Universal Bank, N.A. v. Grause (In re Grause), 245 B.R. 95, 99 (B.A.P. 8th Cir. 2000) (citing Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 342 n.1 (8th Cir. 1987), as supplemented by Field v. Mans, 516 U.S. 59 (1995)). In Field v. Mans, the Supreme Court held that § 523(a)(2)(A) requires justifiable reliance, in which "[j]ustification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases." Id. at 71 (citing the Restatement (Second) of Torts § 545A cmt. b (1976)).

Likewise, a false pretense involves an implied misrepresentation or conduct intended to create and foster a false impression. Merchants Nat'l Bank v. Moen (In re Moen), 238 B.R. 785, 791 (B.A.P. 8th Cir. 1999) (citing In re Guy, 101 B.R. 961, 978 (Bankr. N.D. Ind. 1988)). "[W]hen the circumstances imply a particular set of facts, and one party knows the facts to be otherwise, that party may have a duty to correct what would otherwise be a false impression." Moen, 238 B.R. at 791 (quoting In re Malcolm, 145 B.R. 259, 263 (Bankr. N.D. Ill. 1992) and In re Dunston, 117 B.R. 632, 639-41 (Bankr. D. Colo. 1990)).

"The intent element of § 523(a)(2)(A) does not require a finding of malevolence or personal ill-will; all it requires is a showing of an intent to induce the creditor to rely and act on the misrepresentations in question." Moen, 238 B.R. at 791 (quoting Moodie-Yannotti v. Swan (In re Swan), 156 B.R. 618, 623 n.6 (Bankr. D. Minn. 1993)). The intent to deceive will be inferred when the debtor makes a false representation and knows or should know that the statement will induce another to act. Moen, at 791 (quoting Federal Trade Comm'n v. Duggan (In re Duggan), 169 B.R. 318, 324 (Bankr. E.D.N.Y. 1994)).

With regard to one of the outstanding notes in the amount of $29,000 in principal, plus accrued interest, the debtor requested that the bank renew a portion of an outstanding note in the amount of $12,000 and add an additional $17,000 in new money. The bank officer, being concerned about the ability of the debtor to repay the loan, asked for collateral. The banker and the debtor agreed that appropriate collateral would be a certificate of deposit in the amount of $30,000, which was owned by debtor’s mother. She had previously pledged the certificate of deposit for the benefit of the debtor to collateralize earlier loans. The debtor’s mother agreed to pledge and the banker funded the loan for a total of $29,000. Thereafter, the debtor obtained the certificate of deposit from his mother and delivered it to the bank, along with a signed pledge document. However, the certificate of deposit that was delivered to the bank did not contain the mother’s name, but was in the name of two other persons. The bank officer prepared another pledge agreement, and the debtor took the pledge agreement to the then current owner of the certificate of deposit, his niece. After some period of time, the debtor informed the bank that the niece would not pledge her interest in the certificate of deposit. However, that information was provided to the bank long after the loan had been funded, and even renewed.

I find, as a fact, that the debtor did not intentionally mislead the bank with regard to the certificate of deposit. His mother, who was approximately 80 years old, apparently believed that the certificate of deposit was still in her name, rather than that of her daughter and her granddaughter. As part of an estate planning process, the daughter had begun to manage the financial affairs of the mother and had changed the names on the certificate of deposit, perhaps without the mother’s knowledge. There is no evidence that the renewal of the $12,000 loan, with the additional funding of $17,000, and its eventual renewal in the total amount of $29,000, was obtained by false pretenses, a false representation, or actual fraud.

To except a debt from discharge under the second portion of § 523(a)(2), a creditor must prove, by a preponderance of the evidence, that (1) the debtor made (2) a statement in writing (3) respecting the debtor's financial condition (4) which was materially false and (5) made with the intent to deceive, and (6) which was reasonably relied upon by the creditor. Heritage Bank of St. Joseph v. Bohr (In re Bohr), 271 B.R. 162, 167 (Bankr. W.D. Mo. 2001).

A financial statement is materially false if it "paints a substantially untruthful picture of a financial condition by a misrepresentation of the type which would normally affect the decision to grant credit." Id. Likewise, a financial statement is materially false if it falsely represents the debtors' overall financial condition or has major omissions. Id.

The relevant subjective inquiry, although not dispositive, is whether the complaining creditor would have extended credit had it been apprised of the debtor's true situation. Fairfax State Sav. Bank v. McCleary (In re McCleary), 284 B.R. 876, 885 (Bankr. N.D. Iowa 2002).

For discharge to be barred, the debtor must have acted with intent to deceive. An intent to deceive does not mean that the debtors acted with a "malignant heart." Bohr, 271 B.R. 162, 169 (quoting Agribank v. Webb (In re Webb), 256 B.R. 292, 297 (Bankr. E.D. Ark. 2000)). A creditor may establish such intent by proving reckless indifference to or reckless disregard of the accuracy of the information in a debtor's financial statement. McCleary, 284 B.R. at 888. Factors to consider include whether the debtor was intelligent and experienced in financial matters, and whether there was a clear pattern of purposeful conduct. Id. (citations omitted). Once the creditor establishes that the debtor had actual knowledge of the false statement, the debtor cannot overcome the inference of the intent to deceive with unsupported assertions of honest intent. Bohr, 271 B.R. at 169.

The reasonableness of a creditor's reliance is to be determined in light of the totality of the circumstances. Guess v. Keim (In re Keim), 236 B.R. 400, 402-03 (B.A.P. 8th Cir. 1999) (citing First Nat'l Bank of Olathe v. Pontow, 111 F.3d 604, 610 (8th Cir. 1997)). Among the factors to consider is "whether there were any 'red flags' that would have alerted an ordinarily prudent lender to the possibility that the representations relied upon were not accurate; and whether even minimal investigation would have revealed the inaccuracy of the debtor's representations." Sinclair Oil Corp. v. Jones, 31 F.3d 659, 662 (8th Cir. 1994) (quoting Coston v. Bank of Malvern (In re Coston), 991 F.2d 257, 261 (5th Cir. 1993) (en banc)).

In Bohr, supra, the court found that the lender reasonably relied on the debtors' purported ownership of real estate listed in their financial statements, although the debtors actually held only a remainder interest. A creditor is not required to assume that a debtor is lying or misrepresenting facts in a financial statement. Bohr, 271 B.R. at 168. "While a minimal investigation would most likely have revealed the true ownership of the real estate and thereby exposed the falsity of the financial statements, there were no 'red flags' for the Bank that would have triggered such an investigation" until the debtor informed the bank more than a year after the last financial statement that they did not actually own the property outright. Id. at 168-69. At that point, the bank immediately investigated the debtors' assets and learned the truth.

With regard to the other two loans to Mr. Yost, in the amount of $17,028.52 principal plus accrued interest, and $20,700 plus accrued interest, the bank officer relied on a financial statement presented to the bank by the debtor. That financial statement had been executed approximately three months before the funding of the promissory note shown at Filing No. 31, which was in the amount of $19,900 upon execution and had an outstanding balance of $17,028.52, plus accrued interest, as of the petition date. That financial statement listed $70,000 in equipment. An earlier financial statement received from the debtor showed the value of equipment at approximately $22,000. The bank officer requested the debtor to provide a listing of equipment to support the $70,000 valuation. The debtor assured the banker that the equipment was worth approximately $70,000 and agreed to provide a listing. However, he did not ever provide such a listing.

With regard to the final loan that had an outstanding balance of $20,700 plus accrued interest on the petition date, this note represented a renewal of an earlier debt. The earlier loan was made based upon the earlier financial statement which had listed the equipment being worth $22,000. When it came time for renewal of that note, the bank officer had before him the new financial statement with the equipment value listed at $70,000. Based upon the debtor's assurance that the equipment was worth $70,000 and that he would provide a list of such equipment, the loan was renewed.

On the petition date, the equipment was listed at a value of $3,000 on the bankruptcy schedules. The debtor's explanation for the difference in value on the financial statement from the value on the bankruptcy schedules filed eighteen months later is that as he got deeper and deeper into financial difficulty, he sold the equipment and used the funds for his family purposes. As mentioned above, the debtor did not ever provide the banker with a list of equipment which had a value of $70,000. In addition, the debtor did not testify at trial that he actually had equipment, at any time, that was worth $70,000. I conclude from the evidence presented that the two loans with balances remaining on the petition date, that were not part of the transaction by which the debtor was to post a certificate of deposit as collateral, were obtained by use of a written financial statement which was materially false. It was materially false concerning the debtor's financial condition, upon which the banker reasonably relied, and the debtor presented it with an intent to deceive. The debtor knew that the bank officer was concerned about his ability to repay any or all of the notes. The bank officer agreed to the new loan and the renewal loan based upon the financial statement which listed $70,000 of equipment. The debtor knew that he did not have $70,000 worth of equipment and therefore did not provide a list of such equipment, even though he assured the banker that he did have such equipment.

In conclusion, separate judgment will be entered in favor of the debtor and against the bank on the loan which had an outstanding balance of $29,000 principal plus accrued interest on the petition date. There is no evidence that it was incurred as a result of false pretenses, a false representation, or actual fraud. However, judgment will be entered in favor of the bank and against the debtor with regard to the other two loans which had outstanding balances on the petition date. Those loans are not dischargeable under 11 U.S.C. § 523(a)(2)(B).

DATED: May 13, 2004

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
*Richard Hoch U.S. Trustee
Bruce C. Barnhart

Movant (*) is responsible for giving notice of this order to all other parties not listed above if required by rule or statute.

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	)	CH. 7
Debtor(s).	)	
COMMERCIAL STATE BANK,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	
	)	
BRADLEY KENT YOST,	)	
	)	
Defendant.	)	

JUDGMENT

Trial was held in Omaha, Nebraska, on March 5, 2004, before a United States Bankruptcy Judge for the District of Nebraska on a complaint to object or to revoke a discharge. Richard Hoch appeared for the plaintiff and Bruce Barnhart appeared for the debtor/defendant.

IT IS ORDERED: Judgment is hereby entered in favor of the debtor/defendant and against the plaintiff, the bank, on the loan which had an outstanding balance of $29,000 principal plus accrued interest on the petition date.

IT IS FURTHER ORDERED: Judgment is hereby entered in favor of the bank and against the debtor/defendant with regard to the other two loans which had outstanding balances of $17,028.52 and $20,700 plus accrued interest on the petition date. Those loans are not dischargeable under 11 U.S.C. § 523(a)(2)(B).

See Memorandum entered contemporaneously herewith.

DATED: May 13, 2004

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
*Richard Hoch
Bruce C. Barnhart
U.S. Trustee

Movant (*) is responsible for giving notice of this order to all other parties not listed above if required by rule or statute.