

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
DONALD AND CAROL SCOLLARD,) CASE NO. BK87-1245
)
DEBTORS) A87-204
)
NEBRASKA STATE BANK,) CH. 7
)
Plaintiff)
)
vs.)
)
DONALD PATRICK SCOLLARD,)
)
Defendant)

MEMORANDUM

A hearing on the complaint of plaintiff, Nebraska State Bank (Bank), requesting the Court to declare nondischargeable under 11 U.S.C. § 523(a)(2)(B) the debt owed to Bank by Donald Scollard, debtor, was held May 10, 1988. Craig Raby of Crary, Huff, Clem, Raby & Inkster, P.C., Sioux City, Iowa, appeared for Bank, and Donald Fitch of South Sioux City, Nebraska, appeared for debtor.

Statement of Facts

Debtor has had an ongoing loan relationship with Bank for many years. The Court received as evidence financial statements signed by debtor for the years 1979, 1980, 1981, 1982 and 1983. These financial statements were submitted to Bank each year to help Bank determine whether it should continue to extend credit to debtor. Bank did not independently verify the assets and liabilities listed on the statement.

Each financial statement indicated as an asset a number of stock cows with a corresponding value. The relevant amounts were:

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FILED	
DISTRICT OF NEBRASKA	
AT _____	M
JUL - 1 1988	
Judith M. Napier	
Clerk, U.S. Bankruptcy Court	
By _____	Deputy

Date of financial statement	number of stock cows	Value of stock cows	amount of NSB loans	total assets
10/7/83	90	\$45,000	\$77,882	\$236,890
8/30/82	90	\$45,000	\$75,428	\$236,800
8/14/81	95	\$47,500	\$63,200	\$245,500
8/4/80	95	\$47,500	\$51,210	\$242,700
7/11/79	97	\$48,500	\$38,277	\$252,215

The Court also received as evidence debtor's 1984, 1985 and 1986 federal and state income tax returns. Although debtor declared business income on these returns, none of it is related to care, feeding, buying or selling of stock cows.

Depositions of Jeffrey Gebauer, Jeffrey Dible, John Paulson and Donald Scollard were admitted into evidence. The first three individuals are or were officers of Bank who dealt with debtor's loan account.

The following promissory notes signed by debtor were introduced:

1. Note dated 12/15/78 for \$34,000, Exhibit No. 2, secured by a security agreement dated 12/15/78.
2. Note dated 9/14/84 for \$56,566.99, Exhibit No. 1, secured by a security agreement dated 9/14/84 and 12/15/78. This note renewed the note dated 12/15/78, Exhibit No. 2, as well as a note dated 5/18/84 which is not in evidence.
3. Note dated 11/29/84 for \$13,900, Exhibit No. 4, secured by a security agreement dated 9/14/84. This note renewed Note 7286 which is not in evidence.
4. Note dated 12/3/84 for \$3,000, Exhibit No. 3, secured by a security agreement dated 12/3/84. This note did not renew previous notes.
5. Note dated 2/27/84 for \$3,000, Exhibit No. 5. This note specifically lists a 1967 and a 1969 Chevy 2-ton truck as security.

Attached to Bank's proof of claim, Exhibit No. 16, are four security agreements. The one dated 2/27/84 specifies the Chevy 2-Ton trucks as security. The remaining security agreements contain a general comprehensive description of collateral, including all farm produce and any livestock. The first one is dated 12/15/78, the second 10/7/83 and the third 9/14/84. Not in evidence is the security agreement dated 12/3/84, which secured the note for \$3,000, dated 12/3/84, Exhibit No. 3.

Sometime in May, 1985, debtor told Bank that he did not have the stock cows which had been listed as assets in his financial statements over the five-year period, 1979-83. At the hearing, debtor testified that he had told Bank that he did not have the

cows because of conscience; he knew Bank thought he had the cows, and it bothered him. He knew it was wrong. He testified that he did not know the purpose of the financial statements, but he admitted in a deposition taken prior to this hearing that he knew the Bank would consider and rely upon the financial statements. Scollard deposition at 73.

In April, 1987, debtor and his wife, Carol Scollard, filed a petition for Chapter 7 relief. Bank filed a proof of claim claiming that debtors owed \$111,045.05 at the time of filing, Exhibit No. 16. Bank brought this adversary proceeding on May 14, 1987.

Discussion

Bank contends that it relied on debtor's financial statements and would not have continued to renew and extend its loans to debtor if it had known the stock cows did not exist. In defense, debtor claims that, in 1979, when he told Bank official, John Paulson, that he did not have the cows but was buying more, John Paulson told him to leave the cows in the statement. Mr. Paulson denies this allegation.

A debt incurred for an "extension, renewal, or refinancing of credit [is nondischargeable in Chapter 7] to the extent obtained by--"

(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)(B) (1987).

There is no dispute that the stock cows did not exist but, nevertheless, were included as assets in debtor's financial statements. Nor is it disputed that debtor signed the financial statements and that the statements represented debtor's financial condition. 11 U.S.C. § 523(a)(2)(B)(ii). Moreover, from the testimony and depositions, the Court believes that debtor knew the purpose of the financial statements and knew that Bank was relying on false information. 11 U.S.C. § 523(a)(2)(B)(iv) (1987).

Subsection (i) of Section 523(a)(2)(B) requires not only that a written statement regarding debtor's financial condition be false but that it be materially false. According to each of debtor's financial statements, the value of the stock cows equaled approximately twenty percent of the value of the total assets claimed by debtor. See chart supra p. 2. A misrepresentation of twenty percent of debtor's assets substantially affects debtor's financial position and would affect whether Bank would extend or renew credit to debtor. Therefore, the statement was materially false. 11 U.S.C. § 523(a)(2)(B)(i) (1987).

Next, subsection (iii) of section 523(a)(2)(B) requires proof that the creditor relied on the misrepresentation and that the reliance was reasonable. Clearly, Bank relied on these financial statements during this five-year period, 1979-83, because Bank did not independently verify the items listed on the financial statements nor make any other independent credit check. The more difficult question is whether Bank's reliance was reasonable, which is a question of fact. In re Coyne, No. 87-2557, slip op. at 3 (8th Cir., May 16, 1988).

In Coyne, the Eighth Circuit found that a creditor reasonably relied on a financial statement where the creditor was "not a sophisticated businessman and [was] not experienced in matters of finance and credit." Id. at 4. Given these facts, the Coyne Court held that "it was not unreasonable for [creditor] to rely on [debtor's] financial statement without further investigation." Id.

In the instant case, Bank's officers are, contrary to the creditor in Coyne, sophisticated and experienced in "matters of finance and credit." Sufficient inconsistencies in debtor's financial statements should have generated an inspection by Bank. For example, Bank had no record of debtor depositing any income produced from the sale of cattle, nor does the evidence indicate Bank challenged its absence. Debtor declared the same value and number of stock cows in 1980 and again in 1981. The 1982 and 1983 values and count were also identical. Those numbers should have raised questions. Moreover, if debtor owned cattle, the land on which the cattle were maintained would be reflected on the financial statements as either an equity interest or a lease payable.

Debtor's most recent financial statement in evidence, dated October 7, 1983, listed ninety stock cows, eighty-four calves and three bulls with a total value of \$74,500, which comprised approximately one-third of debtor's assets. On September 14, 1984, eleven months after this financial statement was submitted, debtor executed a note for \$56,566.99, Exhibit No. 1. Cattle are not stable, unchanging collateral. Sizeable fluctuations in value and numbers can occur as a result of births, deaths and sales. More than one-third of debtor's assets were believed by Bank to be in cattle yet Bank did not obtain a current financial statement.

The same reasoning applies to the notes dated November 29, 1984, Exhibit No. 4, and December 3, 1984, Exhibit No. 3--both more than one year after the October 7, 1983, financial statement.

The note dated February 27, 1984, Exhibit No. 5, listed trucks as its security. Thus, Bank did not rely on the existence or nonexistence of stock cows when it extended credit on this particular note.

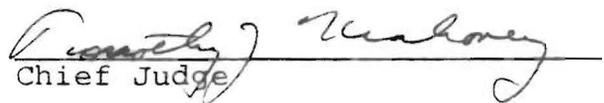
In summary, Bank historically received a new financial statement from debtor every year between 1979 and 1983, but Bank made no independent effort to verify the assets listed even though the financial statements themselves as well as Bank's deposit records should have prompted inquiry by Bank. In addition, in 1984 Bank continued to extend credit without requiring a current financial statement or inspection when it believed a major portion of debtor's collateral was cattle, subject to the price and number fluctuations discussed above.

Therefore, Bank's reliance on debtor's financial statements was not reasonable. 11 U.S.C. § 523(a)(2)(B)(iii) (1987). The Court finds that the total amount of debt owed Bank in excess of the value of any collateral is dischargeable.

Separate Journal Entry to be filed this date.

DATED: July 1, 1988.

BY THE COURT:


Chief Judge