

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
)	
TERRY & SUSAN PFLUEGER,)	CASE NO. BK92-81514
)	
DEBTOR)	A92-8196
)	
NORTH SIDE GRAIN COMPANY,)	
)	CH. 7
Plaintiff)	
vs.)	
)	
TERRY PFLUEGER,)	
)	
Defendant)	

MEMORANDUM

Hearing was held on September 29, 1993, on the above adversary complaint. Appearing on behalf of the debtor was Chris Connolly of Olds and Piper, Wayne, Nebraska. Appearing on behalf of the plaintiff was Michael Harsh and Robert Craig of Kennedy, Holland, DeLacy & Svoboda, Omaha, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(I).

Background

Terry Pflueger operated a farm and a livestock feeding business. He purchased corn from plaintiff North Side Grain Company and used it to feed cattle. He had been doing business with the plaintiff for several years prior to April of 1992. During those years, he purchased grain on credit and within fifteen to thirty days thereafter paid some or all of the amount due. In early 1992, he began to have difficulty paying for the grain within a short period of time. His business was suffering from bad weather, low prices and livestock death losses. The cattle were not gaining weight as fast as he had anticipated, and, therefore, the parties for whom he was feeding cattle refused to pay on a regular basis without proof that the cattle had reached certain weights.

These business problems caused Mr. Pflueger's account with the plaintiff to increase from approximately \$2,000.00 on February 17, 1992, to approximately \$30,000.00 on April 6, 1992.

Plaintiff's president kept a fairly close watch over the accounts receivable status of his customers and became concerned as Mr. Pflueger's debt continued to increase without any significant and regular reduction. The plaintiff's president, Mr. Gubbels, was in regular telephone contact with the debtor during the first few months of 1992 inquiring about payment. Finally, Mr. Gubbels decided that he needed to obtain more information about the debtor's financial condition and requested that the debtor fill out a credit application.

Mr. Gubbels visited with Mr. Pflueger on or about April 10, 1992, and Mr. Pflueger completed the credit application which has been admitted into evidence as Exhibit A. On that document, Mr. Pflueger claimed that he owned 160 acres of real property and rented 745 acres. He listed various crop acreages, the number and kind of livestock he allegedly owned, and listed numerous lenders and suppliers of production input materials. The document did not list a mortgage lender.

The document, on page 2, states above the signature line:

The information given herein is true and is given to cause North Side Grain Company to rely on it for purposes of extending credit to applicant. I authorize the references named herein, both financial institutions and trade suppliers, to release any financial and credit information known to them to North Side Grain Company with the understanding that it will be used solely for credit purposes.

Mr. Pflueger signed the document on April 10, 1992.

After receipt of the document, Mr. Gubbels contacted most of the listed creditors and suppliers. He received information from them concerning the total amounts of debt, the line of credit outstanding, and received information that Mr. Pflueger was slow in paying, but that he was current on most, if not all, of the obligations.

Before he began the credit application process, Mr. Gubbels tentatively determined that he did not want to be exposed to Mr. Pflueger on an account receivable basis for more than \$25,000.00. After he received and verified the financial information on the credit application, he made a final determination that he did not

want the credit of Mr. Pflueger to exceed \$25,000.00. However, although he made such a determination, he continued to permit Mr. Pflueger to purchase grain on credit with the maximum outstanding account receivable reaching approximately \$54,000.00 on May 12, 1992. Thereafter, he put Mr. Pflueger on a cash only basis, and Mr. Pflueger continued to purchase grain on a cash only basis and pay down the account receivable from the high point on May 12, 1992, to the amount of \$41,174.81 on July 21, 1992. No payments were received thereafter on the account receivable, and Mr. Pflueger filed a Chapter 7 bankruptcy petition in September of 1992.

When Mr. Gubbels investigated the credit information on Exhibit A, he did not inquire about the accuracy of the statement concerning real estate owned or rented. As it turned out, Mr. Pflueger was not the owner of any real estate, and the statement that he owned 160 acres was false.

North Side Grain Company filed this adversary proceeding to obtain a judgment of nondischargeability concerning the amount owed by Mr. Pflueger to the plaintiff as of the petition date. That amount, including accrued interest, is \$43,899.82.

Findings of Fact, Conclusions of Law and Discussion

The Bankruptcy Code prohibits the discharge of an individual from a debt for money, property, services, or an extension, renewal or refinancing of credit, to the extent obtained by a statement in writing that is materially false, with respect to the debtor's financial condition, on which the creditor reasonably relied, and that the debtor caused to be made with the intent to deceive. 11 U.S.C. § 523(a)(2)(B).

There is no question in this case that Exhibit A, the credit application, is a statement in writing respecting the debtor's financial condition. The Court finds as a fact that the statement in writing is materially false. The only owned asset listed on the credit application was 160 acres of real estate. No mortgage holder was listed and, when Mr. Gubbels inquired of the listed lenders and suppliers, no creditor mentioned any real estate encumbrance as security. At trial, Mr. Gubbels testified that he was familiar with the value of land in the area at the time and that 160 acres of real estate would be worth approximately \$1,000.00 per acre or \$160,000.00 at the time the credit application was provided. Listing a \$160,000.00 asset that was not owned by the debtor, particularly when it is the only owned asset listed on a credit application, is material to the application and to the overall conclusion one could reach

regarding the financial condition of the party submitting the credit application.

The Court finds that the debtor caused the financial statement with the false information to be made with the intent to deceive. The debtor testified that he was aware that Mr. Gubbels as president of North Side Grain Company was concerned with the debtor's ability to pay down the debt. The debtor testified that he was also concerned about his ability to pay down the debt. On the day he signed the credit application, he believed that he could and he intended to pay the debt to North Side Grain Company. However, he knew on the day that he signed the credit application that to pay North Side Grain Company he would be required to withhold payment to other creditors. He testified in court that on that date he was concerned "to a certain extent" that North Side Grain Company would cut off his ability to purchase grain on credit, and he was aware that was one of the reasons the credit application was requested. He knew that the purpose of the credit application was to make the president of North Side Grain Company comfortable about the debtor's financial condition. He has absolutely no explanation for why he stated in writing that he owned 160 acres of land. He knew at the time that he had never owned 160 acres of land.

This Court finds that the reason that he stated on the written credit application that he owned 160 acres of land was to bolster the appearance of his financial condition. By such activity, he hoped to be able to continue to purchase grain on credit and to keep the plaintiff from proceeding with collection activities. This Court, therefore, concludes that the false written statement concerning the debtor's financial condition was made with the intent to deceive North Side Grain Company.

The final prong of the nondischargeability statute is that the creditor must prove that it reasonably relied upon the materially false written statement. Proof of this and every other element under 11 U.S.C. § 523(a) is by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654, 112 E.D.2d, 755 (1991). There are two components to the reliance requirement. They are: (1) actual reliance and (2) reasonable reliance. Teachers Credit Union v. Johnson, 131 B.R. 848, 854 (W.D. Mo. 1991).

Most courts hold that reliance on a false financial statement does not need to be an absolute reliance or the sole factor considered when extending credit. Teachers Credit Union v. Johnson, 131 B.R. at 854. In addition, reliance on a false financial statement need only be a contributory cause of the extension of credit. Id. 855.

In this case, Exhibit A, the credit application, specifically states that debtor acknowledged that the document would be relied upon when considering the grant of credit. In addition, the testimony of the debtor leads this Court to believe that he understood the statement would be relied upon. Finally, the testimony by Mr. Gubbels is that he did rely upon the credit application and the information contained therein when making the determination to continue to extend credit. Therefore, the Court finds that the creditor did actually rely upon the materially false written statement concerning the debtor's financial condition when he chose to continue to extend credit and to forebear from collection activity.

The final element to be proved by the creditor is that its actual reliance was reasonable. The debtor suggests that the creditor could easily have checked the public records and made a determination that the debtor did not own 160 acres. Therefore, from the debtor's point of view, any reliance on the credit application could not have been reasonable. This Court does not accept the position of the debtor. First, the credit application was not specific with regard to the location of the real property. It would not have been easy, simply from a review of the credit application, to determine the county in which the real estate was located or to determine the appropriate county office for checking the records.

Second, the creditor did check with most of the lenders and trade suppliers. What the creditor found was that the debtor was current on payments with his creditors, but that he was slow paying. The slow pay portion of the information was not a surprise to Mr. Gubbels because it was the debtor's tardiness in paying the accounts receivable which caused him to inquire concerning the financial condition of the debtor in the first place.

Third, the debtor had done business with the creditor for approximately five years and during that time there had been no difficulty with payment, although some payments were slow. This business relationship was satisfactory to both parties, and Mr. Gubbels, on behalf of the plaintiff, had no reason to mistrust the debtor or question the honesty of the debtor when he requested information about his financial condition.

Fourth, there were no "red flags" either in the relationship between the parties or in the credit application itself which should have alerted Mr. Gubbels to the possibility that the representations relied upon were not accurate.

At least one circuit court has held that

Whether a creditor's reliance was reasonable is a factual determination to be made in light of the totality of the circumstances. Among the circumstances that might affect the reasonableness of a creditor's reliance are: (1) whether the creditor had a close personal relationship or friendship with the debtor; (2) whether there had been previous business dealings with the debtor that gave rise to a relationship of trust; (3) whether the debt was incurred for personal or commercial reasons; (4) 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 (5) whether even minimal investigation would have revealed the inaccuracy of the debtor's representations.

In re Ledford, 970 F.2d 1556, 1560 (6th Cir. 1992). After considering the totality of the circumstances in this case, the Court finds the creditor did everything a reasonably prudent person would have done under the circumstances to determine the accuracy of the financial information provided. It, therefore, follows that the creditor reasonably relied upon the materially false written statement concerning the debtor's financial condition.

The creditor has satisfied all of the requirements of the statutory section with regard to the nondischargeability of the debt. The question then becomes: How much of the debt is nondischargeable? The total amount outstanding on the petition date, including accrued interest pursuant to the contractual agreement contained in the credit application, was \$43,899.82. Although only a portion of that amount represents credit extended after the creditor was presented with the false credit application, this Court finds that the total amount should be deemed nondischargeable. The creditor by relying upon the credit application not only determined that future credit should be extended, but determined that the prior credit extension should not be immediately deemed subject to collection activities. In other words, the creditor not only relied on the false written statement for future credit decisions, but, because of the representations in the false financial statement, made a determination that there was no need to pursue collection of prior accounts receivable immediately. Mr. Gubbels so testified and also testified that he believed, based upon the credit application, that although payment from the debtor was slow there

were assets available to assure payment of the claim as well as those of the other trade suppliers.

In the case of In re Marx, 138 B.R. 633 (Bankr. M.D. Fla. 1992), a creditor was owed a debt in excess of \$125,000.00. The creditor asked for payment of the debt. In response, the debtors offered a security interest in certain property, and a promissory note in the amount of the debt. In exchange, the creditor agreed not to take legal action to collect on the account and also agreed to extend additional credit. It ultimately came to light that the appraisal of the mortgaged property had been fraudulently altered. The issue before the court was whether the "old debt" was nondischargeable in addition to the "new debt" which was given to the debtors after the execution of the promissory note and mortgage based upon fraudulent grounds.

The "old credit" extended prior to the deceitful conduct and then renewed based on the fraudulently procured promissory note and mortgage, is also excepted from discharge. An "extension of credit" within the meaning of § 523(a)(2) is "an indulgence by a creditor giving his debtor further time to pay an existing debt". Furthermore, § 523(a)(2) specifically references the renewal or refinancing of credit. These terms necessarily contemplate the prior granting of credit to the debtor and arrangements to continue the credit when the debtor cannot repay according to the original terms. Thus the Bankruptcy Code protects the creditor who is deceived into forbearing collection efforts.

The bankruptcy laws are designed to furnish relief for the honest but unfortunate debtor. Through the fraud exceptions to discharge, Congress intended to provide that such relief be limited to honest debtors, thus discouraging fraud. Accordingly, this Court holds that the exception to discharge provision of § 523(a)(2) is not limited to new value.

Id. at 636-37 (citations omitted) (emphasis added). This also appears to be the position of the Eighth Circuit. In the case of Matter of Van Horne, 823 F.2d 1285 (8th Cir. 1987), a debtor obtained a renewal of an old debt using false pretenses. The Eighth Circuit held that under § 523(a)(2)(A) the renewed debt should not be discharged. In Van Horne, the Eighth Circuit was not dealing with any new debt, but only the renewal of an old debt.

Therefore, the Court finds that judgment should be entered in favor of the plaintiff and against the defendant for the full amount of the debt. The amount of \$43,899.82 is nondischargeable.

Separate journal entry shall be filed.

DATED: December 2, 1993.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: Chris Connolly, Attorney for debtor
Michael Harsh, Attorney for plaintiff
Robert Craig, Attorney for plaintiff

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TERRY & SUSAN PFLUEGER,)	CASE NO. BK92-81514
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<u>DEBTOR(S)</u>)	
)	
NORTH SIDE GRAIN COMPANY,)	CH. 7
Plaintiff(s))	Filing No.
vs.)	<u>JOURNAL ENTRY</u>
)	
TERRY PFLUEGER,)	
)	DATE: December 2, 1993
<u>Defendant(s)</u>)	HEARING DATE: September
)	29, 1993

Before a United States Bankruptcy Judge for the District of Nebraska regarding Adversary Complaint.

APPEARANCES

Chris Connolly, Attorney for debtor
Michael Harsh, Attorney for plaintiff
Robert Craig, Attorney for plaintiff

IT IS ORDERED:

Judgment is entered in favor of the plaintiff North Side Grain Company and against the defendant Terry Pflueger, in the amount of \$43,899.82, all of which is nondischargeable in this Chapter 7 bankruptcy case.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: Movant, Objector/Resistor (if any), Debtor(s) Atty. and all parties appearing at hearing
[] Chapter 13 Trustee [] Chapter 12 Trustee [] U.S.Trustee

Movant is responsible for giving notice of this journal entry to all other parties if required by rule or statute.