IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:	)	CASE NO. BK04-40714
	)	A04-4063
MICHAEL LEE SIMPSON,	)	
	)	CH. 7
Debtor(s).	)	
OMAHA BURLINGTON EMPLOYEES CREDIT UNION,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	
	)	
MICHAEL LEE SIMPSON,	)	
	)	
Defendant.	)	

MEMORANDUM

Trial was held on March 10, 2005, in Lincoln, Nebraska. Joan Watke Stacy appeared for Omaha Burlington Employees Credit Union and Willis G. Yoesel appeared for the debtor. 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 is an employee of BNSF, formerly known as Burlington Northern Santa Fe Railroad. He is also a member of the Omaha Burlington Employees Credit Union. Since 1998, he has borrowed money from the credit union on several occasions. In September of 2002, he borrowed money on an unsecured basis. He submitted a loan application which, by its own terms, required him to list all of his creditors and the amount owed to each, plus the monthly payment on each debt.

Although in September of 2002 he was purchasing a mobile home with a debt well in excess of $17,000, he did not list the debt and indicated in two places on the loan application that he rented. He also did not list several other debts, including many credit card debts. In the space provided on the loan application, he listed only two debts.

The credit union, based upon his loan application information, refinanced a prior signature loan, bringing the total amount of the signature loan to $5,000.

In early January 2003, Mr. Simpson purchased a new vehicle and borrowed the money from the credit union to pay off an earlier vehicle loan and purchase the new vehicle. He once again completed a loan application and once again failed to list all of his debts. This time, he indicated on the loan application that he owned his home, but provided no information about any debt against it. He listed two credit cards, but they were different from the credit cards listed in the application that he had submitted just over three months earlier. Based upon the credit application form, the credit union loaned him approximately $28,000 which was secured by the new vehicle.

Mr. Simpson filed a Chapter 7 petition in March of 2004. His schedules reflect numerous debts which were in existence both in September of 2002 and January of 2003. The credit union liquidated its collateral and applied the proceeds of the sale of the vehicle to the debt. However, there remains a total debt, including the signature loan and the deficiency resulting from the sale of the vehicle, in the amount of $11,424.85 as of March 10, 2005.

The credit union filed this adversary proceeding alleging that the obligation owed to it should not be discharged because the debts were incurred through fraud by the debtor.

At trial, the credit union presented testimony from its secretary-treasurer and from a member of the credit committee. They discussed the internal policies of the credit union with regard to what the credit union considered when making loans. Their testimony is consistent with the written policies which were admitted into evidence. Loan officers of the credit union rely totally upon the information provided in the loan application. From a review of the loan application, a loan officer is able to determine the total amount of debt the borrower has before and after the granting of the new loan, and is able to determine, by virtue of a ratio formula contained in the credit union's policies, whether the borrower has sufficient income to service all of the debt. Without accurate information concerning the borrower's debts, the credit union cannot assess the ability of the borrower to make the payments.

In this case, I conclude as a fact that had all of the debts been listed, neither the September nor the January loans would have been made.

Mr. Simpson admits that he did not include all of his debts on either of the loan applications. He suggests that his failure to do so was because there was insufficient room on the loan application to list all the debts that he had.

The loan application has at least four lines which may be used to list the debts. The application itself also explains that the borrower may attach an additional page showing any other debts that are not able to be fit into the original application. Mr. Simpson says the credit union never provided him with an extra page so he assumed that he did not need to list the other debts.

It is Mr. Simpson's position that the credit union did not rely upon the loan application in either case. He suggests that the credit union was only interested in whether he was an employee of the railroad and whether he was currently working. As far as he is concerned, he provided the credit union with all of the information that it needed, or that the loan officer wanted. He does acknowledge that stating on the original application that he rented was an error. With regard to the second loan application, he claims that he informed the loan officer that he owned a house, but that it was being sold and that is the reason that he did not list any information about the debt on the house.

The credit union alleges that the debts should be deemed non-dischargeable under 11 U.S.C. §§ 523(a)(2)(A), (a)(2)(B), and (a)(6).

To establish fraud within the context of 11 U.S.C. § 523(a)(2)(A), 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)).

To except a debt from discharge under 11 U.S.C. § 523(a)(2)(B), 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).

Under section 523(a)(6), a debtor is not discharged from any debt for "willful and malicious injury" to another. This requires a deliberate or intentional injury targeted at causing harm to the creditor. Hobson Mould Works, Inc. v. Madsen (In re Madsen), 195 F.3d 988, 989 (8th Cir. 1999); Osborne v. Stage (In re Stage), No. 04-6055EM, slip op. at 7-9 (B.A.P. 8th Cir. Mar. 10, 2005). There is no evidence in this case that Mr. Simpson gave erroneous information about his debts with an intent to harm the lender. Therefore, no further discussion of this subsection is necessary.

Sections 523(a)(2)(A) and (a)(2)(B) are mutually exclusive. First Nat'l Bank of Olathe v. Pontow, 111 F.3d 604, 608 (8th Cir. 1997). Because the allegations in this case deal with two written loan applications, § 523(a)(2)(B) is the applicable provision. Each element of § 523(a)(2)(B) is discussed below.

a. "Materially false"

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." Bohr, 271 B.R. at 167. Likewise, a financial statement is materially false if it falsely represents the debtors' overall financial condition or has major omissions. Id. In the Bohr case, a financial statement listing real property as an asset was materially false in light of the fact that debtors held only a remainder interest in the property, subject to a life estate, so the interest had no value. Without the real estate, the debtors' net worth dropped from $270,000 to $8,000, so the misrepresentation was material.

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). In McCleary, the lender argued that the debtor's financial documents were materially false because they omitted certain outstanding obligations and did not accurately reflect the ownership and value of certain business equipment. The court disagreed, noting that the unlisted debt, a $6,000 balance due on a revolving account with a supplier, was not significant in comparison to the debtor's net expenditures of $448,000 for the first seven or eight months of the year. Moreover, the debtor's failure to provide the bank with details of his obligations for leased equipment was not "substantially untruthful" as the information sought was readily apparent from the face of the documents. The court opined that "a cursory review of [the profit and loss statement] should have put [the lender] on notice as to potential outstanding lease obligations." McCleary, 284 B.R. at 886.

I find that the loan applications were materially false because of the failure to list debts which were significant in number and in amount. The lender would not have extended credit had it been made aware of Mr. Simpson's true financial situation.

b. "Intent to deceive"

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 court in Bohr found intent to deceive based on the debtors' admission that they knew the land did not belong to them and that the financial statements containing information to the contrary were submitted for the purpose of obtaining credit. The inference from those facts was that the debtors intended to deceive the lender. Id.

By contrast, the court in McCleary found no intent to deceive because the bank was so lax in obtaining full disclosure of the debtor's financial situation. "The Bank was content with the limited information it received about Debtor's financial picture. Debtor's failure to provide more relevant and accurate information cannot be interpreted as an intent to deceive in these circumstances." 284 B.R. at 888.

I find here an intent to deceive. Mr. Simpson knew that the application requested that he list all his debts. He also knew that he had not listed all his debts on either application. His claim that there was not enough room on the form to list everything and that the lender had not provided additional sheets that would have allowed him to fully comply is not logical or credible. He is a 27-year-old man with a high school education and a job that paid him $36,000 per year at the time of the applications. He had the information about his debts and the ability to obtain a plain sheet of paper to list all his debts. The applications clearly informed him of the need for accuracy and the criminal penalty that could be imposed if false statements were submitted.

c. "Reasonable reliance"

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 Keim, the court ruled that the creditor could not have reasonably relied on handwritten and incomplete financial statements. The creditor extended credit primarily because the debtors listed a one-sixth ownership interest in a building. The creditor did not verify the ownership interest, or the value of the interest or of the building. The bankruptcy appellate panel agreed with the bankruptcy court that no reasonable person would have been able to discern the debtors' financial condition solely from the financial statement provided, and reproved the creditor for not asking for proof of the debtors' ownership interest, not conducting a title search, not procuring an appraisal, and not even verifying the existence of the building. Keim, 236 B.R. at 403 n.2.

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.

In McCleary, supra, the court concluded that the lender failed to protect its own interests.

> The Bank, in this case, abandoned its normal financial disclosure procedures, it relied upon financial information provided by a third party [the debtor's prior lender], and it showed a lack of critical curiosity about the documents that were produced. Many, if not all, of the grievances made by the Bank at this time could have been easily remedied by obtaining a full financial statement in the beginning. Under all of these circumstances, this Court must conclude that any reliance upon the information provided by Debtor was not reasonable.

284 B.R. at 888.

This issue is a close one. The lender could have protected itself by obtaining a credit report on the borrower. The lender could have questioned the differences in the information on the two applications submitted only a few months apart. The lender could have required more information about the status of the home ownership reflected on one, but not both, of the applications. On the other hand, the lender is not required to assume the borrower is lying or intentionally leaving off relevant information. Here, the lender has specific policies in place that assume accurate applications and has specific procedures to follow to determine the creditworthiness of borrowers. It followed the policies and procedures.

I find that the lender's reliance on the information provided was reasonable.

The debt is not discharged. Separate judgement will be entered.

DATED this 11th day of March, 2005.

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
Joan Watke Stacy
Willis G. Yoesel
U.S. Trustee