UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

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In re:

ROBERT L. FIELDS and
PATRICIA A. FIELDS,

MEMORANDUM DECISION

Debtors.

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COMMUNITY FINANCE GROUP, INC.,
a Minnesota corporation,

Plaintiff,

BKY 10-50165

v.

ADV 10-5019

ROBERT L. FIELDS,

Defendant.

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At Duluth, Minnesota
November 7, 2013.

This adversary proceeding came before the court for trial, at St. Paul. The Plaintiff appeared by its attorney, Boris Parker. The Defendant appeared personally and by his attorney, Jeffrey M. Bruzek. The trial consumed nearly three full days of courtroom time. The following memorandum decision is entered pursuant to Fed. R. Civ. P. 52(a) and Fed. R. Bankr. P. 7052. It incorporates findings of fact and conclusions of law.

INTRODUCTION

The Plaintiff is described by Andrew Vilenchik, its "General Manager," as "mainly a residential mortgage originator" that also "conducted some commercial transactions."[1] Per Vilenchik, its capital for lending is provided by "private investors."

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[1]The Plaintiff's business operations apparently are more wide-ranging than that. Two years ago the Eighth Circuit Court of Appeals affirmed the dismissal (by the United States District Court for the District of Minnesota) of an action by the Plaintiff against a sovereign foreign nation, arising from the Plaintiff's attempt to import gold from Africa. *Community Finance Group, Inc. v. Republic of Kenya*, 663 F.3d 977 (8th Cir. 2011). The dismissal was on the ground of sovereign immunity.

NOTICE OF ELECTRONIC ENTRY AND
FILING ORDER OR JUDGMENT
Filed and Docket Entry made on 11/07/2013
Lori Vosejpka, Clerk, By JRB, Deputy Clerk

The Defendant is a debtor in bankruptcy under Chapter 7. For thirty years, he was engaged in real estate development and associated building construction, eventually using multiple corporate entities for separate functions in the development process. The companies he formed to carry on construction and property management functions were LandCor Construction, Inc. ("LCCI") and LandCor, Inc. ("LandCor"). By 2005, the Defendant had completed over twenty real estate development projects.

In the middle years of the last decade, the Defendant promoted a commercial real estate development project in Otsego, Minnesota, known as "Main Street Otsego." He formed an artificial business entity, Main Street Otsego, LLC ("MSO"), through which he pursued the project.

On November 6, 2008, the Plaintiff advanced $500,000.00 to MSO on a short-term (60-day) loan, secured by a second mortgage against MSO's real estate. The specific inducement that the Defendant made to the Plaintiff in order to obtain the loan is one of the fundamental factual disputes between the parties. So is the defensibility of Vilenchik's reliance.

As the Plaintiff would have it, the advance was made on two understandings that Vilenchik formed, based on express statements by the Defendant. The first such was that MSO had to complete certain tenant improvements in the development's buildings before a senior lender, GCI Capital, Inc., would release other monies to MSO pursuant to a previously-granted line of credit. The second was that MSO would use the proceeds of a loan from the Plaintiff for the improvements and only the improvements. In its complaint and pretrial briefing, the Plaintiff also claimed that the Defendant misrepresented other facts material to the Plaintiff's risk as lender, by oral statements regarding his companies' repayment ability and by written statements of his personal financial condition.

The Defendant denies all that. He insists that before the Plaintiff made the loan he disclosed that he was in significant default on interest obligations to GCI Capital, and that he needed a loan from the Plaintiff to cure them.

MSO did not repay the loan from the Plaintiff when due. It made a number of small payments of accrued interest after the due date. GCI Capital eventually foreclosed its first mortgage against the property. MSO and the Defendant lacked the means to make any payment to the Plaintiff after that.

After the Defendant filed for bankruptcy relief, the Plaintiff timely commenced this adversary proceeding. It seeks a money judgment and a determination of nondischargeability.

The Defendant moved for summary judgment on a threshold issue, whether there was a legally-enforceable debt obligation running from him personally to the Plaintiff. He was granted summary judgment on all but one of the theories of personal liability argued by the Plaintiff. The theory reserved for trial was whether the Defendant had committed common law fraud in inducing the Plaintiff to lend to MSO. Order Re: Defendant's Motion for Summary Judgment [Dkt. No. 20], 18-21.[2] Were such a liability established, the question would be whether it was excepted from discharge under bankruptcy law. The Plaintiff pled 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(2)(B) as its statutory bases for nondischargeability.[3]

As a confusing trial came to a close, the focus of the parties' disputes seemed to emerge: whether the Defendant had made actionable misrepresentations as to specific subject matter, to induce the Plaintiff to lend; and whether the Plaintiff's reliance (on the part of Vilenchik) on the depiction of MSO's financial posture and the intended uses for the Plaintiff's loan qualified as actionable under governing law, state and federal.

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[2]The Plaintiff's assertion of personal liability in the Defendant as co-debtor or guarantor failed as a matter of law; it had no support in the grossly-inadequate language of the instruments that the Plaintiff's own related entity prepared. Order Re: Defendant's Motion for Summary Judgment, 7-15. Its bid to affix personal liability through a piercing of the corporate veil of MSO was rejected, on the ground that it was not even in suit; the text of the complaint had no fact-pleading or legal assertions for the remedy. *Id.,* 15-19.

[3]For the record: a proceeding to determine the dischargeability of debt is a core proceeding in bankruptcy, 28 U.S.C. § 157(b)(2)(I), hence within the bankruptcy jurisdiction of the federal courts, 28 U.S.C. § 1334(b), and subject to entry of judgment at the order of a bankruptcy judge, 28 U.S.C. § 157(b)(1). Under current Eighth Circuit precedent, the bankruptcy court has jurisdiction and statutory authority in dischargeability litigation to order and enter judgment on the underlying debt, if it determines that the debt is nondischargeable. *In re Ungar*, 633 F.3d 675, 679-680 (8th Cir. 2011).

The overarching theme of the defense is that the Plaintiff, during Vilenchik's evaluation of MSO's application for credit, created (or at least suffered) the conditions for its own half-million dollar financial disaster. That accusation is somewhat cavalier; and that is apparent from the very wording that the Defendant's counsel uses, particularly given the time during which the relevant events took place. However, the point is the entree into the most salient legal issue, the defensibility of the Plaintiff's reliance.

The Plaintiff's evidentiary presentation was long and grueling. It alone consumed more than the two days originally allotted for the trial. The Plaintiff's counsel dwelled on many factual minutiae, which came into evidence without objection despite questionable relevance to the theory of inducement articulated by the Plaintiff. Sprinkled throughout the record, there were bits and pieces of evidence that could have helped to support an outcome for one side or the other. At the end, it was fairly clear that neither the Defendant nor Vilenchik had been completely forthcoming in their testimony as to exactly what had transpired between them. It also might have been a matter of each not being completely honest with himself.

The record promised to be difficult to parse through, so the submission of proposed findings of fact and conclusions of law linked by reference to the evidence was ordered in lieu of closing argument or post-trial briefing. When the Plaintiff's were submitted and they were pored over, it appeared that many of the key factual points asserted as events of fraud lacked *any* evidence to support findings to their effect. Others required leaps of inference. All of it required attention to the detail of witness testimony regarding oral statements, subjective awareness, and intent.

It was not crystal-clear that the Plaintiff had met its burden. Nonetheless, there was something disturbing about what the Defendant had done to get a loan for MSO from the Plaintiff. And the fact that it could not be defined initially did not mean that the Plaintiff had not met its burden. Cutting against these suspicions, of course, was case law's dictate to exact strong proof of all elements from a creditor-plaintiff, and to give narrow construction to bankruptcy law's provisions for exception from discharge. *E.g.*, *In re Unterreiner*, 699 F.3d 1022, 1025 (8th Cir. 2012) (creditor's burden to prove all elements); *In re Miller*, 276 F.3d 424, 429 (8th Cir. 2002) (narrow construction); *Werner v. Hofmann*, 5 F.3d 1170, 1172 (8th Cir. 1993) (ditto). The vagaries of the Plaintiff's record thus made post-trial decision-making difficult.

TREATMENT OF EVIDENCE AND ARGUMENT

For this matter, there is a substantial overlap in the essential elements for liability under nonbankruptcy law and for dischargeability in bankruptcy. As a result, the determination on the underlying liability should be the first step. This will require the fixing of liability as a matter of fact and law and then, if warranted, the liquidation of the debt.

The gravamen of the Plaintiff's surviving claim is common law fraud, whether it be based on oral representations as to material facts or on written statements respecting MSO's and the Defendant's personal financial condition.[4] If the record supports the fixing and liquidation of a debt under that theory, its dischargeability is then to be determined.[5]

Because both variants under 11 U.S.C. § 523(a)(2) sound in fraud, most of the elements will be common to all stages of analysis. The Defendant's inducement to the Plaintiff came out of a specific sequence of historical events, one involving severe financial stress on both

[4]Common-law fraud was the *only* pleaded basis of liability left in suit after the Defendant was granted partial summary judgment. Order Re: Defendant's Motion for Summary Judgment, 21. For some reason, the Plaintiff's counsel briefed for trial the same arguments for liability (judicial estoppel, personal guaranty, and piercing of the corporate veil) that were rejected with dispositive effect in the order on the Defendant's motion.

[5]Neither side's lawyer followed this sequence in briefing, oral argument, or the analysis in their post-trial submissions. Counsel were supposed to take some responsibility for organizing the sprawling record they had created, but they did not do that completely. In particular, the lawyers failed to apply the state law of fraud to their analysis of the proof or even to frame their submissions in mind of the threshold existence of a debt. Somehow, the directives of the order on the Defendant's motion for summary judgment [Dkt. No. 20, 19-21] were completely ignored. That is particularly baffling, as to the Plaintiff; it was as if there were no realization that if one does not have a pre-petition claim under law against a debtor, there is nothing to be excepted from discharge in bankruptcy. (And the disposition on that motion had been charitable to the Plaintiff and its lawyer, in recognizing a pleaded claim for fraud under nonbankruptcy law even though all of the Plaintiff's expressly-articulated theories of liability had no merit. It could have all stopped right there.) It is fortunate that the elements identified in the separate bodies of law governing liability and dischargeability are closely cognate, *In re Freier*, 604 F.3d 583, 588 n.2 (8th Cir. 2010); the task of separate analysis on the threshold inquiry largely transferred to the dischargeability stage.

MSO and the Defendant. Thus, it is appropriate to open with fact-finding on that. These facts are common to all three steps of the analysis. The broader points of historical, transactional, and documentary origin are not in controversy between the parties.

Backdrop Facts

A. The Defendant and His Business Enterprise, in Mid-2008.

At all relevant times, MSO held one part of a larger, multi-parcel commercial real estate project that the Defendant was developing in Otsego, a Wright County, Minnesota city on the Mississippi River.[6] The Defendant had commenced the project before 2005. He had planned it on several separate parcels of real estate. The parcels were owned by separate entities, each apparently directed toward distinct end-uses in development. Each parcel bore its own financing for development. In shorthand, the Defendant and others referred to the whole project variously as "the Waterfront development" and "Main Street Otsego."

The parcel owned by MSO was to feature two buildings, one for primarily retail usage and the other for combined retail and office usage. By early 2008, the exteriors and common areas of the buildings had been finished. Individual spaces were to be finished off to meet particular tenants' needs.

The whole Waterfront/Main Street Otsego project was part of a phenomenon of the first half of the last decade in the Twin Cities metro area: a frenetic development of land in the formerly exurban area, i.e., outside the established second-tier suburbs and thirty miles or more from the Minneapolis-St. Paul core in all directions. Regionally, the pace of this activity began to slow in 2006. There were various reasons, not the least being a growing excess of supply over demand for the developed end-product whether commercial or residential. Over the ensuing two years the pool of available financing contracted. Preexisting lenders got more demanding of their developer-borrowers. The expansion of franchised retail businesses into new geographic areas

[6]At various places, the parties describe MSO as a "waterfront commercial development." Apparently the river was the water, though this was never clarified.

also slowed. It became more difficult to get leasing commitments for partially-completed projects.[7]

The Waterfront/Main Street Otsego development had other, more immediate external problems of its own. A major reconstruction of the main feeder highway adjacent to the development (apparently Route 101) disrupted access to the site and impaired visibility. For as long as that lasted, there was a sharp drop in potential tenants' interest in the site. The Defendant's various companies, including MSO, did not meet their projections for occupancy and generation of rental revenue from a number of separate developments. At the same time, however, the companies had substantial fixed costs for the financing of the initial phase of development, as well as ongoing build-out and administrative expenses.

The initial financing for MSO came from GCI Capital, Inc., a Maple Grove-based originator of commercial loans. GCI Capital had granted MSO a line of credit in a total amount of $7,500,000.00. MSO was to draw on the line as needed for the costs of ongoing build-out and other purposes. GCI Capital, however, had control over MSO's right to draw, and could suspend it. The Defendant personally guaranteed MSO's obligations to GCI Capital.

After originating the credit to MSO, GCI Capital sold it out on participation to a group of small banking institutions. GCI Capital continued to service the account. The terms of the arrangement required unanimous consent by participant-banks to any modification of the terms of repayment, security, and so forth.

By April, 2008, MSO was experiencing significant difficulty in meeting its interest obligations to GCI Capital. It had drawn on the line to the extent of about $5,800,000.00. Though this had not exhausted the line as originally granted, GCI Capital had frozen the Defendant's ability to make further draws.

On April 18, 2008, MSO and GCI Capital entered a forbearance agreement. In consideration for the payment of approximately $73,000.00 in interest arrearages, GCI Capital

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[7]The parties' evidence has broader references to some of this history. The details of these observations, however, come out of the experience of this court's bench in presiding over multiple bankruptcy cases for failed local real estate developments, developers, and builders, over the full past decade.

relieved MSO of the obligation of current payment on accruing interest for a further period. GCI Capital was given the right to collect rents from the property, for application pursuant to the original note executed by MSO. All remaining accrued interest was to be paid when the full principal became due under original terms: August 15, 2008, only four months later. The *daily* interest accrual was $1,223.37.

Concurrently, the Defendant was persistently asking GCI Capital to renegotiate the terms of the borrowing, to allow an additional draw, and to convert the facility to a “permanent” loan with a long-term amortization. In persistent response, and at the instance of its participants, GCI Capital was demanding a full cure of all remaining interest arrearages as the prerequisite of even beginning discussions. More crucially, it would promise to discuss no more than an extension of the due date for a fixed period of a few months beyond that reset under the forbearance.

During the summer and fall of 2008, threats to declare default on the August 15 due date, to accelerate, and to foreclose featured prominently in the interchanges between the Defendant and Pat O’Brien, the GCI Capital employee on the MSO account.

Throughout that summer and early fall, MSO had no more than three tenants under signed leases, between the two buildings. Only a small fraction of the total space had been leased. The Defendant and the employees of LandCor Company, Inc., his management company, were trying to get commitments from others. However, they had only a handful of prospects. None of those progressed significantly toward signing a lease during that summer. MSO was generating revenue of about $9,000.00 per month from the existing leases.

Otherwise, MSO had little or no capital in its own right from which to fund further tenant improvements, to meet administrative expenses, to pay interest to GCI Capital, or to offer in reduction of principal toward a conversion of the line of credit.

GCI Capital did not declare default in mid-August. However, O’Brien’s demands to the Defendant became increasingly threatening. These demands were fueled in large part by its participant-banks' own need for accountability to the bank examiners, as to the realization on their investment in the MSO credit.

Over the middle half of 2008, the Defendant implored O'Brien for accommodations for MSO. His entreaties ran from cajoling, to proffer of terms, to bluff and bluster. None of that had an effect on GCI Capital's demand: there would be no negotiation and no discussion toward any longer-term arrangement at all unless the past-due interest was paid in full and a declaration of default would be made if it were not paid soon. As of August 15, 2008, the interest totaled $222,653.33, plus $41,277.37 in late fees. On October 6, 2008, GCI Capital issued through counsel a formal notice of default and demand for payment of the full debt. O'Brien and the Defendant continued to discuss the prospect of cure and extension (and the Defendant continued to plead for better and long-term arrangements). As of October 7, 2008, GCI Capital's demand for cure had reached $334,824.97.

At the same time, the Defendant was struggling with much the same difficulties for several of his other project-entities.[8] All of the Defendant's companies lacked means to make good on debt obligations that they had contracted not so very far in the past, but under assumptions as to finance and credit that simply no longer applied.[9] The use of the word "desperate" is often histrionic when applied to any sort of financially-oriented subject, even in the context of bankruptcy. However, it fits the Defendant's situation in September, 2008. And, indisputably, it describes his state of mind at that time.

[8]That much appears from the evidence. The details are not in the record, but they are irrelevant. What is important, is uncontested: the Defendant was beleaguered on all fronts, and his whole business edifice was facing collapse. (In his testimony at trial, the Defendant opined that such a collapse was not inevitable until a full year later, and that he still had viable options in mid- and late 2008. The rest of the evidence drives entirely to the contrary.)

[9]By the end of September, 2008 the Lehman Brothers financial enterprise had collapsed. This precipitated a crisis of confidence in the financial sector that ran worldwide. This all resulted in the deepest economic downturn since 1938.

B. The Dealings Between the Plaintiff and the Defendant.

This was the backdrop when the Defendant and Vilenchik first encountered each other in mid-October, 2008. They met initially not long before October 21, 2008, at Bella Sera, a restaurant that the Defendant owned. They were there separately, for their own purposes, and were introduced in passing by Todd Rocha, a mutual acquaintance.

After that evening, Rocha cross-communicated that the Defendant was looking for commercial financing, and that Vilenchik might be able to provide it through the Plaintiff. The Defendant then approached Vilenchik. They met at the Plaintiff's offices on October 21, 2008. The Defendant told Vilenchik that he ran large companies engaged in commercial real estate development, both for construction and operation, and that he had a current need for funding for several projects. In turn, Vilenchik summarized the Plaintiff's guidelines for lending. He described the limited circumstances under which the Plaintiff would make loans secured by real estate, and the conditions it would require. He invited the Defendant to submit an application for a loan.

The Defendant and Vilenchik next met on October 24, 2008, at Bella Sera. The Defendant furnished a lavish meal for Vilenchik and other attendees. The Defendant had collected a variety of documents in a format that the Defendant called a "bank book," i.e., a body of information to support a request for credit on behalf of one of his companies. He gave it to Vilenchik. This particular submission was oriented toward an extension of credit to MSO, which was then understood between Defendant and Vilenchik as the first project for which the Defendant would seek credit from the Plaintiff.

The Defendant had a formula for the content of a "bank book." He used members of his companies' staffs to assemble much of the content, but sometimes he added materials himself. Among the content of this "bank book" was a document that was titled as a rent roll for MSO's properties. The book, however, did not include "financials" for MSO itself, i.e., the customary accounting summaries of financial condition like balance sheet, cash flow or profit and loss statements, etc. When Vilenchik queried the Defendant about this, the Defendant told him that

MSO was “just a shell company,” maintained for asset ownership, and that the relevant “financials” were the income- and asset-related documents that he had included for LCCI and LandCor, which carried on his operations and actually handled the cash flow from his enterprise. The book also included personal financial statements for the Defendant and his wife, an organizational chart for his enterprise, and resumes of the people who staffed his operations.

On that occasion, Vilenchik removed a number of documents from the “bank book” and returned the binder and the remainder to the Defendant. Vilenchik made no commitment to the Defendant at that time and told him he would “look at the material.”

The Defendant contacted Vilenchik by phone several times during the ensuing weekend. The two agreed to meet for a visit to the MSO property, which was done on October 28. In the meantime, Vilenchik had Priority Title, Inc., the real estate service company that he owned, search the public land records as to the property. On that search, the mortgage in favor of GCI Capital emerged as the only lien or encumbrance of record.

During the drive to MSO’s site, the Defendant took Vilenchik by other properties that he had developed in the area. Once there, Vilenchik “did an external inspection only.” He concluded from that that it was “a well-managed property.” He and the Defendant had further discussions at that time, and then at a luncheon meeting at Bella Sera on November 4, 2008. Other persons participated in that meeting.

On November 6, 2008, Vilenchik met with the Defendant at Bella Sera to conduct the closing on the loan. The documentation was prepared through Priority Title. When the parties found mistakes in its content and the lack of office infrastructure at Bella Sera prevented the generation of new, corrected texts, the Defendant and Vilenchik executed hand-amended versions of the originals. Vilenchik later tried to get the Defendant to execute integrated, corrected documents, but the Defendant never did so.

After payment of some $73,000.00 in real estate tax arrearages, a loan origination fee of $20,000.00 to the Plaintiff, and various fees and charges, a net disbursement of $393,810.27

was made to MSO on November 7. Five days later, the Defendant directed $335,223.34 of it to paying the interest arrearages owing to GCI Capital. The record does not reflect how MSO used the balance of the loan proceeds. However, it is clear that none of it was used to fund tenant improvements in either building.

The Defendant, on behalf of MSO, executed an amended and restated promissory note in favor of GCI Capital on November 15, 2008. With accompanying amendments to associated documents, this extended the due date of MSO's liability to GCI Capital to March 1, 2009.

MSO did not pay its obligations to either GCI Capital or the Plaintiff, when due. GCI Capital foreclosed its mortgage against MSO's real estate. The Plaintiff did not intervene in the foreclosure process as a junior lienor. After completion of the foreclosure, GCI Capital took ownership.

TREATMENT OF THE THREE LEGAL THEORIES

I. Defendant's Liability Under the Common Law of Fraud

Minnesota law identifies the elements of fraudulent misrepresentation, i.e., common law fraud, as:

> (1) there was a false representation by a party of a past or existing material fact susceptible of knowledge;
>
> (2) made with knowledge of the falsity of the representation or made as of the party's own knowledge without knowing whether it was true or false;
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> (3) with the intention to induce another to act in reliance thereon;
>
> (4) that the representation caused the other party to act in reliance thereon; and
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> (5) that the party suffer[ed] pecuniary damage as a result of the reliance.

U.S. Bank N.A. v. Cold Spring Granite Co., 802 N.W.2d 363, 373 (Minn. 2011); *Hoyt Properties, Inc. v. Prod. Res. Grp., L.L.C.*, 736 N.W.2d 313, 318 (Minn. 2007); *Martens v. Minn. Min. & Mfg. Co.*, 616 N.W.2d 732, 747 (Minn. 2000); *Specialized Tours, Inc. v. Hagen*, 392 N.W.2d 520, 532 (Minn. 1986). *See also City of Geneseo v. Utilities Plus*, 533 F.3d 608, 617 (8th Cir. 2008) (citing and applying *Hoyt Properties*).

Essentially all of these elements were in contention between the parties, based upon radically different "narratives," i.e., asserted versions of the facts, as to what the Defendant said and represented to Vilenchik in the inducement to obtain a loan for MSO, and what Vilenchik did in response.

In its pleading and briefing, the Plaintiff asserted that multiple statements by the Defendant, oral and written, would satisfy the first element. This thrust fizzled out as to most of them. As to many particular facts, the Plaintiff did not offer evidence as to the bare making of representations or their falsity. However, the receipt of evidence going to a single, central representation consumed the better part of the trial. As to that point, the record had a preponderate thrust--toward findings in favor of the Plaintiff.

A. Alleged Representations in Oral Form

1. The Representations, and Falsity

a. The Need for the Loan

The major--and eventually pivotal--dispute between the parties lay in the oral representations that the Defendant made to Vilenchik about a single subject: the nature of MSO's need for a loan from the Plaintiff and the uses to which the Defendant would put the proceeds to satisfy that need. The parties' narratives of the events were diametrically opposed. Needless to say, the implications for a case for fraud on the part of the Defendant were quite different.

Neither the Defendant nor Vilenchik ever prepared or issued a written memorandum of this representation, by way of a "note to file" or a confirming letter or e-mail message sent to the other party. Nor was the content of the Defendant's representation ever mentioned in any written communication on another subject, contemporaneously or later. The only evidence toward this crucial element is the two witnesses' in-court testimony as to the historical event. Thus, the fact-finding proposed a true "he said-he said" problem. It could be resolved only on a determination of which content was the more likely reflection of what the Defendant really said.

Ultimately, the finding best supported by the evidence, weighed on an assessment of credibility and in light of all the surrounding circumstances, is as follows: during their very first conversation (October 21, 2008), before Vilenchik decided to make the loan to MSO, the Defendant told Vilenchik that his personal funds were "frozen" due to an FDIC investigation of Riverside Bank (a financial institution in which he was an owner and principal). Then, during the site visit on October 28, 2008, the Defendant told Vilenchik that GCI Capital had "frozen" further draws on MSO's line of credit due to "construction issues," i.e., until MSO got more paying tenants into occupancy and had better cash flow. Thus, between the two stages of representation, the Defendant told Vilenchik that he needed $500,000.00 to fund the completion of tenant improvements in MSO's buildings, for committed prospective tenants identified on the rent roll submitted in the "bank book." This, he said, would promote tenants taking occupancy. That, in turn, would enable him to prevail upon GCI Capital to allow further draws on the line. He specifically mentioned a day spa for which the space had to be prepared by January 1, in order to put the tenant into occupancy as part of his case for a draw.[10] He proposed the draws from GCI Capital as the source for repayment to the Plaintiff within the short term for which the Defendant was seeking credit for MSO.

This finding preponderates over the one advanced by the Defendant. As the Defendant would have it, he told Vilenchik that MSO needed a loan of the required magnitude to pay a significant amount of past-due interest to GCI Capital, as a condition "to get an extension" on the debt secured by the first mortgage.

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[10] A "Tiffany Day Spa," designated as "LOI," appears in the rent roll [Exh. 25] tendered in the bank book.

As between the two, the content of Vilenchik's testimony is simply more credible, and that of the Defendant less so.[11] Not the least indicator is that Vilenchik actually gave MSO the money, given all of the circumstances and particularly in light of GCI Capital's freeze of draws on the line of credit. The substratum of the Plaintiff's narrative is that the freeze was prompted by lower rent revenue than projected.[12] Vilenchik testified that he would not have made the loan on behalf of the Plaintiff had he known that interest owing to a first mortgagee was so significantly in arrears, and that a loan from the Plaintiff was needed just to bring the interest current.

This statement aligns naturally with considerations of external credibility. A normally-motivated lender that did not usually advance on the security of a junior mortgage lien, would scarcely decide to do that where the loan would only roll the burden of a past default by the owner-borrower right down to the later lender itself and its junior-priority security--unless it had the prospect of timely cash payment from a predictable source. In his testimony, the Defendant never stated that

[11]The issue comes down to the credibility of the content, because witness demeanor was close to a wash on the matter of credibility. Neither party's demeanor was greatly sincere, spontaneous, or forthcoming, but neither one lost to the other on comparison. The Plaintiff's attorney interrogated Vilenchik through a long series of leading questions, to which too many answers were terse and conclusory. Not enough of the story was developed in Vilenchik's own, uncoached words. The defense never objected to this; and even after admonishment from the bench, the form of questioning went right back to that. This always casts a pall on such testimony when it is offered as an important part of a case in chief. When called for the defense case (and even to a degree as an adverse witness in the Plaintiff's case), the Defendant was more voluble. But frequently his testimony became glib, almost excessively detailed in the defense case after a partial lack of memory during his testimony as an adverse witness. It sounded too rehearsed. And, it was not irrelevant that the Defendant had long made a good living out of aggressively selling his developments in an open market, and had obviously developed skills in persuasion and a certain amount of charm. Finally, there was only one third-party witness on the matter of the Defendant's representation and disclosure, one Duane Kropuenske. He was called by the Plaintiff. Kropuenske did testify, on cross-examination by the Defendant's counsel, that he had accompanied the Defendant to the site visit, "as a friend to ride along with him." He stated that Vilenchik "was present" during that interlude, when the Defendant told *him--Kropuenske*--that he needed the loan to pay unpaid interest. This was an odd frame of reference to use, in referring to *Vilenchik* gaining particular knowledge. Kropuenske was calm and straightforward in delivering the testimony, but he repeatedly qualified that what he was saying was "to the best of [his] recollection." He was not exactly a neutral third party as to the issue: at the time he was working for the Defendant, on compensation by commission, trying to find financing for the Defendant or for prospective purchasers of his projects. He had been the president of Riverview Bank when the Defendant was on its board. And he was not charged to take any active role in the site visit, i.e., to negotiate with Vilenchik; he was only to "ride along," "as a friend." It is possible that the Defendant's intent was to have him there, as a future witness if one became necessary. In the end, Kropuenske's credibility is best assigned as equivalent to the Defendant's, but no more than that. It can not really serve as strong "corroboration," as the defense argues.

[12]The following determinations on credibility came out of the thought-process that is outlined at more length in *In re Conoryea*, 459 B.R. 384, 388 ff. (Bankr. D. Minn. 2011).

he told Vilenchik that GCI Capital was committed to advance more money or to renegotiate past terms, on a cure of past-due interest. He only said that he told Vilenchik that "if [he] had a loan to make that cure [he] *could work with* GCI for an extension and modification on that loan." From the face of such a statement, a new lender could draw only one reasonable conclusion: its own chances of getting repaid through the borrower-entity itself on a short-term loan would be completely subject to the unfettered discretion of GCI Capital.

It is also significant that a key part of the Defendant's narrative was a disclosure he said he made to Vilenchik: he had threatened GCI Capital with a Chapter 11 filing earlier in 2008, to no avail toward loosening the line or modifying payment terms then.

It simply is not credible that a lender approached as Vilenchik was, would go ahead to advance half a million dollars, in reliance on a senior lender becoming so accommodating as to fund a repayment to the Plaintiff of a debt incurred to cure an existing interest default to that very senior lender. The end-result for GCI Capital from such a process would have been the capitalization of defaulted interest, something it clearly would not do directly.[13] The Defendant would have one believe that Vilenchik was counting on all that falling into line, to ensure that the Plaintiff was repaid within 60 days, and became willing to lend.

And, as the Defendant would have it, the Plaintiff was willing to do that for an applicant who had already evinced a willingness to subject an earlier lender's claim to restructuring through bankruptcy reorganization, over its objection if necessary. It is quite unlikely that any lender in Vilenchik's position would have undertaken any such risk. Under the Defendant's narrative of his disclosures, he would have Vilenchik buying not only the promise of huge selflessness from GCI Capital; he would also have the Plaintiff accepting the real chance of a peck of trouble if MSO went into bankruptcy later, as it had already contemplated once.

In light of the fact that Vilenchik *did* go ahead, it is simply more credible from the perspective of general, rational human experience that he did so on the representation that he

[13] It goes without saying that participant-banks would have no part of such a move, if they were under pressure from bank examiners and at that point in history.

attributes to the Defendant. The content was consistent with a strategy plausibly to be attributed to GCI Capital, toward longer-term realization from MSO: reloosening the line of credit for draws on an objective showing of progress toward a functional, leased-up rental property, but only in the form of rent revenues bolstered from occupancies ready to begin.

Vilenchik's treatment of MSO's application was clearly not the action of a seasoned, hard-nosed commercial lender experienced with this particular sort of lending, the level of collateral and other assurances that should be extracted from a hampered applicant, and so forth. But he did have lending experience, and he did have a process to evaluate a borrower. And even to a less-experienced lender, more risk of a significantly higher level screams out from the representation that the Defendant posits, than from the one that the Plaintiff maintains. Vilenchik would have been able to make such an assessment at that time. He did testify that he would not have had the Plaintiff lend on the situation described in the Defendant's representation, whatever the other assurances of repayment. Going ahead as he did is not rationally consistent with receiving a statement like the Defendant says he made.

And finally, it is more likely from the Defendant's perspective that he would have made a statement of the content advocated by the Plaintiff. Given his desperation, it is less likely that he would have said what he says he did. After all, he was quite experienced on the matter of getting and giving credit in a demanding industry. He knew what lenders wanted. It would have been quite candid for a prospective borrower to admit its distress by disclosing that it had considered filing for Chapter 11, and then threatened an earlier creditor with that. But how *likely* would it have been for a knowledgeable applicant to spill that? And then, would a new creditor-party really be likely to lend in such a situation, to a borrower who was willing to make such threats, and on a grant of subordinate-priority security and with no stated assurance of future accommodation by the senior creditor?[14] If the goal was to actually get the money when other quarters for obtaining financing had closed, the likelihood of getting repaid would have been very low at best.

It necessarily follows that the Defendant's representation was false. The Defendant stated in testimony that he had only two tenants on-site at MSO under rent-generating signed leases in September-October, 2008. Whatever the accuracy of the rent roll he gave to Vilenchik, he had no more than three. By that time, he had agreed to "modify" the leases of "a couple existing tenants" in the larger Waterfront development, giving them reductions in rent to compensate for "the construction shutdown." As to actual rent generation from MSO beyond that, as of September 8, 2008, "we had some contingent leases, that would have been signed."

The sense of this last statement is obscure. There is no evidence that any such leases were actually entered for space in MSO's buildings, before the Plaintiff disbursed the loan to MSO. Nor, of course, is there any evidence that MSO financed any tenant improvements, for future tenants or even "on spec," in the MSO development before then.

It is also relevant that during October, 2008, the Defendant was doggedly trying to find a buyer for the MSO development, as an alternative to completing the build-out in MSO's own right. He was having ongoing contacts with DeWaay Financial, a Des Moines-based brokerage that had suggested it might be able to assemble a group of individual investors to enter and fund the remainder of the MSO development were it given an ownership interest. It appears that the Defendant was discussing several possible sale structures with DeWaay, including some in which he and the LandCor entities would have an ownership stake or operational involvement. None of this involved immediately boosting occupancy and rent revenues.

Most to the point, he had no understanding with GCI Capital to the effect of what he says he represented to Vilenchik, i.e., that on a cure of interest arrearages he had a palpable chance of renegotiating terms with GCI Capital that would make MSO financially sound and push it forward

[14]True, for most of the last decade there were specialized lenders to distressed business borrowers, "DIP lenders" willing to finance the costs of operation of a business actually in Chapter 11, and the like. The Plaintiff was not one of those. There is no evidence that the Defendant thought it was. And even in the last decade, such lenders demanded a lot more than Vilenchik was willing to take.

in operation, and that the Plaintiff would be repaid when due from the results. The uncontroverted evidence is that GCI Capital, under express direction from its hard-pushing participants, was voicing no accommodation beyond a further extension of the due date by 60 to 90 days, upon a cure of interest default and payment of past-due real estate taxes. The Defendant had no proffer from GCI Capital that incorporated any further draw, even on an increase of revenues from the property. He had had no communication that GCI Capital's participants countenanced additional success in leasing as an alternative to receiving simple cash, in the form of a cure of default.

So: the representation the Defendant made to Vilenchik, of the content previously found, was false. It went to both past and contemporaneous fact, the specific financial stresses on the MSO development that required near-term remediation if the project was to stay whole under MSO and a prospective short-term lender were to be repaid by MSO in its own right. The fact content was susceptible of the Defendant's knowledge; he was the central actor, in control of all of MSO's operations, and he had full access to all of its records.

As to this oral statement, then, the Plaintiff has established the first element of fraud under Minnesota law.

b. Other Sources of Repayment

In its complaint and pretrial briefing, the Plaintiff made much of several other representations that the Defendant allegedly made orally to Vilenchik in inducement, as to his ability to give alternate and secondary sources of repayment, were "all hell to break loose," i.e., the negotiations with GCI Capital to fail and it were to make no further advance to fund repayment of the Plaintiff. Per the briefing, and the opening part of Vilenchik's testimony, these alleged representations included: (1) LandCor and LCCI had "several million" in "receivables," which "would be collected in 60 to 90 days," from which the Plaintiff could be paid; (2) the Defendant had a $700,000.00 certificate of deposit as his and his wife's personal property, and could liquidate that "immediately" if needed; (3) the Defendant had interests in "warehouses in Brooklyn Park," "some free and clear" of encumbrances, that "could be used to pay off the loan"; and (4) the City of Otsego owed MSO or another of his companies "$2 million," which would be released once tenant improvements were completed and the two buildings "opened."

During the remainder of trial, however, the proof festered, foundered, or was not even forthcoming--as to the making of every one of these alleged oral misrepresentations.

First, the Plaintiff never bore out with admissible proof the truth or falsity of any representation as to accounts receivable owing to the Defendant's other companies. This is even given the Defendant's representation that certain entries on his *personal* financial statement represented accounts and notes receivable in favor of various business entities in which he had partial or full ownership, and that a creditor "can rely on" such entries. The Plaintiff produced no evidence that such "receivables" were not matched to actual, enforceable legal commitments under contract, or that any such commitments had no collectible value in late October, 2008. A finding that a pre-loan representation of ownership was false or that such assets were not *then* available for satisfaction of debt, is not compelled from the sole fact of a creditor's later, post-default failure to get recourse from such assets.[15]

Second, there is a similar failure of proof as to any representation that went to the actual existence and availability of a personally-held certificate of deposit as a backup source of payment. Valenchik testified, in vague fashion, that at some unidentified time funds held personally under a certificate of deposit proved unavailable to the Defendant or for application to the Plaintiff's claim, due to control that the Defendant's wife Patricia had and exercised over the account via holder-status.[16] That was all that came from Vilenchik; there was no testimony on the point from the Defendant. No documentary evidence as to the certificate of deposit itself was offered. A bare finding that the Defendant had some claim of ownership to such an instrument might be marginally

[15]Counsel's labored interrogation of the Defendant on this point failed to produce much of any specificity.

[16]Valenchik never explicitly stated that Patricia had failed to grant access to the funds. He also said, in rueful tone, that he had never thought to obtain some sort of consent from her before the loan was disbursed.

defensible. But no more than that could be found. The very sparse evidence cannot support a finding that any broad representation that the funds would be available was false when made.

Third, the Plaintiff produced no evidence at all as to whether the Defendant did--*or did not*--hold ownership interests in suburban warehouse properties in October, 2008. So, there is nothing on which to find falsity here, either.[17]

Fourth, and finally, is the alleged representation as to a realizable right to substantial payment from the City of Otsego. The evidence as the subject matter and its falsity is sparse, somewhat contradictory, and ultimately inconclusive.

The Plaintiff's counsel tried to use testimony *from Vilenchik* to prove that any such right to payment was actually in favor of another entity in the structure of the Waterfront development, one owned by Patricia Fields. He, obviously, was not the right witness.[18] It seems that the Plaintiff got no satisfaction on the debt from any such quarter, in the end. But there is no proof in the record, as to the actual existence, nature, terms, or enforceability of any such development-related right to payment, let alone the identity of the beneficiary, the control over the receipt of the payment, and whether the Defendant held such control as a matter of fact or law. It is not possible to make any material finding as to this subject matter.

c. Outcome on First Element, as Premised on Oral Representations

The Plaintiff has satisfied the first element of the test for common law fraud. The analysis on the existence of a debt may go forward on the basis of that representation, as found. With the failure of the other oral representations originally alleged and advanced by the Plaintiff, it is not necessary to include them in any further analysis.

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[17]Raising this specific representation as fraudulent was a waste of time for all parties. It was not a waste of much time, beyond the half-hour spent in combing the record for some mention by a witness that proved not to be there.

[18]For some reason, the Defendant's lawyer did not object as to the massive issue of foundation, if this proffer was for the actual state of affairs rather than for Vilenchik's own conclusions from later investigation.

2. Defendant's Knowledge of Falsity

With the specific representation as to the need for the loan found as such, there is no dispute as to the second element: the Defendant flat-out knew it was false.

GCI Capital had not ever agreed to reopen the line of credit once the Defendant got a higher lease-out of the buildings. It had not even stated a willingness to discuss a reopening. The Defendant had no more than the possibility that GCI Capital would extend his day of reckoning in full, the due date on the note, a duty to cash out in full, and that only for a few months. That was the only prospect he could expect from the lender that controlled MSO's fate. It was the only prospect he could proffer to another lender. Most likely, the Defendant was straining to believe that he could somehow negotiate his way around or beyond that brick wall, with the indefatigable mind-set of the entrepreneur. But he had absolutely nothing on which to see a chance of doing that to success.[19]

It is almost beside the point, but it should be noted: even had his false story been true, the Defendant did not have its own predicates for a productive outcome. MSO did not have tenants committed and ready to occupy in the near term, as soon as space was improved to their needs. At most there was some unknown (but very small) number of parties that had expressed some interest in MSO's site.[20]

The Defendant's representation bolstered the pretense that a resultant draw from GCI Capital would fund repayment on a short-term extension of credit from the Plaintiff, with a clear projected line of causality from the Plaintiff's disbursement to its repayment. The representation and the pretense were false. The Defendant knew that.

[19]To the contrary, the availability of credit worldwide was dropping and locking in as the great crash of October, 2008 occurred.

[20]The evidence, even the Defendant's testimony, never did identify such parties or flesh out their status with much specificity. The undated rent roll for Building B given to Vilenchik [Exh. 25] had two parties designated with "LOI," which the Defendant equated with having given a letter of intent, i.e., the close precursor to a firm commitment to rent. The September 8, 2008 internal rent roll for Building B [Exh. 7] does not list either of them among the eight names identified with "Future" or "Prospect."

3. Defendant's Intent to Induce

Again, given the nature of the representation found, made in the context and at a specific point in the flows of events, there is no doubt that the Defendant made this representation to induce the Plaintiff (through Vilenchik) to loan MSO the half-million dollars he sought.

In his testimony as an adverse witness, the Defendant acknowledged that he had "dealt with" financial institutions, on loans he sought in order to finance his development projects, for as long as he had been engaged in the sector (30 years). He admitted he was well-aware of what lenders needed to evaluate an application for financing, both in the form of documentation (accounting-oriented summaries like financial and income statements and balance sheets; leases; site plans and drawings; and financial projections) and in the representation of other facts material to the lender's risk in extending credit. He acknowledged that one factor, "what the [borrowing] entity would do with the funding" from a loan, was material to a lender's decision, and that a lender typically relied on trustworthy representations as to that point.

More importantly, the Defendant attested to his experience on the other side. While he was an investor in Riverview Bank and a member of its governing board, he had made use of such materials when the board reviewed loan applications submitted for its approval, loan account activity, and lending operations generally.[21] In that capacity, he had expected borrowers' representations to be accurate and their loan applications complete. He acknowledged that lenders appropriately relied on all information provided by a prospective borrower. And finally, he conceded that if information were missing or misstated, "the decision [to lend] can be misguided," and a lender might lend to a borrower to which it otherwise ought not to lend and to which it would not have lent.

In approaching Vilenchik toward getting a loan from the Plaintiff, the Defendant was no tyro. He knew just what any lender to a commercial venture would want from him in connection with an application. He had a well-developed format to present the supporting documentary portion

[21] The Defendant stated that he had been a member of this bank's board for only a short time. However, his testimony as to the activity of a bank's board in relation to actual loan files was extended, detailed, consistent, and quite credible.

of the submission. He also knew that a lender would look beyond the snapshot image in most accounting statements and the recapitulation and hypothetical of historical data and projections; the need for the funding from a loan and the contemplated uses of it were significant considerations as well. In that connection, the role of the money, as conceived by the borrower, would be a key consideration--whether the borrower would put it to uses that would logically bolster and increase the likelihood of repaying the lender, as part of a cohesive business plan dealing with current realities, is undeniably material to any decision to lend.

To different effect, Vilenchik was less experienced and less knowledgeable than the Defendant--specifically as to the risks inherent in lending like the Defendant sought for MSO, and the review that a lender should perform to gauge that risk. Though Vilenchik tried to project worldliness and a degree of bravado in his testimony, his initial description of the Plaintiff's past business is suggestive: primarily in originating loans on residential mortgages, "some" lending in the commercial sector. He did not testify to the length, breadth, frequency, or magnitude of his experience in the commercial sector, for the Plaintiff or otherwise. He attested to experience in commercial leasing and attendant finance, but this was phrased tersely and broadly. Vilenchik may have gained it as much on the preparation of rented or owned headquarters for the Plaintiff, as in professional engagements involving third-party borrowers or tenants. The actual extrinsic investigation he performed on MSO's application was workmanlike, but it was far from detailed or nuanced.

None of that could have been lost on the Defendant, as he approached and worked with Vilenchik toward getting and closing on the loan.

From his experience and with his knowledge, the Defendant gave Vilenchik a representation that dovetailed right into a fully-structured story: though MSO's operation was currently locked into a low level of intensity, the receipt of $500,000.00 could jumpstart it using currently-realizable revenue prospects that only needed seed money for tenant improvements. And in this proposal, once that happened the prior lender would revest confidence in MSO, reopening the line of credit enough to enable the Plaintiff to be repaid. And, of course, the implication was that

MSO thereafter could build up its operation on an enhanced base of higher occupancy and greater revenue generation.

Only one reasonable inference flows from all of that: in making the representation as part of a dynamically-oriented component of a larger presentation, the Defendant fully intended that Vilenchik would rely on it, and that Vilenchik would see that the Plaintiff loaned him the $500,000.00 that he sought. This satisfies the third element under Minnesota common law.

4. Reliance, as Consequence Caused by Inducement

The fourth element presents the most challenging issue here, and the one in sharpest contention between the parties. The Minnesota Supreme Court's wording for the elements of fraudulent misrepresentation, p. 12 *supra*, suggests in isolation that *actual* reliance alone is sufficient. Such a standard would not require or allow for an after-the-fact judicial determination as to whether the reliance was defensible.

However, under Minnesota law the *justifiability* of a plaintiff's reliance has long been a consideration on this element. *E.g.*, *Spiess v. Brandt*, 230 Minn. 246, 253, 41 N.W.2d 561, 566 (1950) (noting the "well-established rule that in a business transaction the recipient of a fraudulent misrepresentation . . . is justified in relying upon its truth, although he might have ascertained its falsity had he made an investigation"); *Davis v. Re-Trac Mfg. Corp.*, 276 Minn. 116, 117, 149 N.W.2d 37, 38-39 (1967). In determining justifiability, the question is whether the misrepresentation was reasonably calculated to deceive, not the average person, but "a person of the capacity and experience of the particular individual" who was deceived. *Spiess v. Brandt*, 230 Minn. at 254, 41 N.W.2d at 567; *Boubelik v. Liberty State Bank*, 553 N.W.2d 393, 400 (Minn. 1996). Minnesota law specifically rejects an objective standard, often termed "reasonable reliance," for common law fraud. *Murphy v. Country House, Inc.*, 307 Minn. 344, 351, 240 N.W.2d 507, 512 (1976) ("Fraud is proved with reference to the specific intelligence and experience of the aggrieved party rather than a reasonable-man standard").

The Minnesota Supreme Court has not always been consistent in its modifier-vocabulary on this point:

> . . . a party can *reasonably* rely on a representation unless the falsity of the representation is known or obvious to the listener. . . . The listener is not under an obligation to conduct an investigation and thus may rely on the representation so long as it is not known by the listener to be false and is not obviously false.

Hoyt Properties, Inc. v. Prod. Res. Grp., L.L.C., 736 N.W.2d 313, 320-321 (Minn. 2007) (emphasis added) (citing to *Spiess v. Brandt*, 230 Minn. at 253, 41 N.W.2d at 566). However, even when using the adjectival modifier "reasonable," this standard is more deferential to the victim of fraudulent misrepresentation than would an objective, community-oriented standard. Under the latter, the fact-finder might fault a victim for not having caught the misrepresentation, just because someone else would have second-guessed, ransacked the background, and otherwise acted out of more diffuse suspicion, toward uncovering the fraud.

That onus, however, is not borne by a plaintiff claiming fraud under Minnesota law. If the falsity of a communication of material information is not "obvious" from the communication's content, as a matter of logic internally- or externally-oriented; and if the recipient has no extrinsic knowledge of facts that would call the truth of the communication into question; the recipient may rely on it. The recipient may change position without jeopardy to its option for restitution if the representing party in fact lied. Again, to emphasize, absent notice of possible falsity, facial or held previously or contemporaneously from extrinsic sources, the recipient "is not under an obligation to conduct an investigation." *Id*.

The justifiability of reliance is an issue of fact. *Berg v. Xerxes-Southdale Office Bldg. Co.*, 290 N.W.2d 612, 616 (Minn. 1980). Here, despite the Defendant's strenuous opposition, the evidence supports the finding that Vilenchik--and hence the Plaintiff--properly (justifiably) relied on the Defendant's representations as to the needs prompting MSO's loan application and the purposes to which the funds would be applied.

To be sure, the representation was not the only point of information on which Vilenchik relied, to decide to make the loan. Vilenchik testified that he did background work between October 28 and November 4, 2008. From that he concluded that the Defendant's personal credit was “exemplary,” from personal credit reports for the Defendant and his wife that he had obtained. He found no record of a default on MSO’s obligations to GCI Capital. The only lien of public record against MSO’s real estate was the mortgage lien in favor of GCI Capital.

In his testimony under cross-examination, Vilenchik acknowledged that he had looked heavily to asset strength (“my biggest concern”) as a source of repayment, as the Defendant had proffered for use should “all hell break loose.” But, in deciding to lend on the specific terms he gave MSO, he envisioned that as a second-stage resort. The Defendant’s oral representation on a central, material fact, supported a whole proposal, under which the Plaintiff would promptly exit MSO’s debt and asset structure after one lending-in. Under the whole pretense, this would serve MSO’s needs. And a short-term engagement with MSO served the Plaintiff’s needs, limiting exposure while still generating profit from the extension of credit.[22]

Even from jaded hindsight, the story has internal consistency: the Plaintiff would get repaid and exit, quickly like the Defendant seemed to contemplate, and after the Plaintiff had directly facilitated a loosening of preexisting financial means available to MSO. All of that was plausible on its face, in the contemporaneous context.[23]

Once the Plaintiff put in its evidence (Vilenchik’s testimony and the documentary submissions that the Defendant had given Vilenchik), the justifiability standard shifted the burden to the Defendant to produce evidence of something different--the possibility of a contrary state of affairs, that had been apparent from contemporary manifestations already known to Vilenchik from elsewhere, that would prompt doubt in the Defendant’s veracity. The justifiability standard did not impose a duty on Vilenchik to make inquiry of GCI Capital, as to the Defendant’s current status with

[22]The anticipated profit obviously was to come from the substantial up-front origination fee that the Plaintiff charged MSO, than from the interest to accrue over a short 60-day term.

[23]The Defendant’s objection to the Plaintiff’s reliance on this specific representation begs the question: why wouldn’t Vilenchik rely on it in the first instance? Even before the 2008 economic crash, no rational lender would have thrown half a million dollars into a real estate development entity that seemed to be stalled, on a primary or exclusive expectation of getting paid *later*, *untimely*, and from sources other than the entity’s own means. The Defendant’s counsel never got Vilenchik to admit that he had weighted the Plaintiff’s alternatives for recourse in that skewed a way.

it and whether he had the available avenue of respite that he had represented to Vilenchik.

The Defendant did not carry that burden. There was little or nothing in all of the documents in Vilenchik's possession, from his observations on-site, or in what the Defendant told him that was contrary to the thrust of the Defendant's representation. Prudence, or a greater degree of sophistication or experience, would have dictated more questions to the Defendant or to third parties. But under the justifiability standard, the Plaintiff is to be taken as it actually stood; and the inquiry is to what was obvious to *that* party, in *that* context.

So, to sum it up: Vilenchik, and hence the Plaintiff, actually relied on the Defendant's misrepresentation. This finding is supported both by objective fact and subjective intent. The representation was a key part of a specific business strategy and credit proposal proffered by the Defendant. It was logically essential to a coherent notion of granting a particular amount of credit on a facially-realistic prospect of being repaid. Vilenchik testified that had he known of the actual need for the funds--to ease only the immediate pressure from a powerful creditor to which MSO was in default and which was not offering any mid- or long-term resolution--he would not have considered or actually made the loan.

After that, Vilenchik's reliance on the misrepresentation, in context, was justifiable. There was nothing in the representation's content; nothing in the Defendant's other submissions to the Plaintiff; nothing from the pro forma, standard credit investigation that Vilenchik performed; and nothing from Vilenchik's experience with the Defendant in the very brief relationship that they had had, that raised any question about the truth of what the Defendant said.

The Plaintiff has satisfied the fourth element of common law fraud as to this oral representation.

5. Resultant Damage

The Plaintiff's satisfaction of the fifth element is virtually self-evident. In consequence of making a loan to a failing business entity that Vilenchik would not have made had he known the true state of the Defendant's plans for using the proceeds, the Plaintiff was left unpaid. The Plaintiff did not receive payment from the means represented by the Defendant. It was not satisfied from third-party sources of repayment. And it was ultimately unprotected by a junior mortgagee's position against real estate that held a sputtering commercial development that was failing before completion.

The Defendant's argument on causation has no merit at all: "Finally, the loss incurred by the Plaintiff was not caused by the Defendant, but rather the Plaintiff's own failure to act." This is just a retread of the ploy implicit in the Defendant's other arguments. The Plaintiff's loss--a failed and unsatisfied extension of credit--resulted directly and proximately from the Defendant's fraudulent misrepresentation. It is irrelevant that Vilenchik relied on other things in addition to the representation; it was an important and necessary part of a larger pretense.

The defense brief attributes the Plaintiff's loss to the natural result of a course of "high risk" lending. This was nothing but rhetoric, with no support in the evidence. The Defendant's lawyer never offered a thing to establish that the Plaintiff was a "high risk" or sub-prime lender or that its general program assumed any particular level of risk at all.

6. Outcome

On the basis of the single oral representation previously found as fact, the Plaintiff has satisfied all five elements of fraudulent misrepresentation under Minnesota common law. Thus, the Defendant is liable in damages to the Plaintiff, for fraudulently inducing the Plaintiff to lend to an insolvent and failing business entity that he owned, which was unable to repay the Plaintiff in its own right and which was not capable of gaining the ability to repay the Plaintiff. *Consolidated Foods Corp. v. Pearson*, 178 N.W.2d 223 (Minn. 1970).

B. Representations in Written Form

In Minnesota, the common law of fraudulent misrepresentation applies without regard to the format (oral or written) of the representation and without respect to the subject matter of the communication other than a materiality requirement.[24]

[24] This contrasts with the two alternate dischargeability provisions of § 523(a)(2), which have been termed "mutually exclusive." *In re Long*, 774 F.2d 875, 877 n.1 (8th Cir. 1985); *First Nat'l Bank v. Pontow*, 111 F.3d 604, 608 (8th Cir. 1997). This latter refers to the fact that § 523(a)(2)(B) applies by its terms to written statements concerning a debtor's financial condition. By negative inference, oral statements are to be governed by § 523(a)(2)(A) and § 523(a)(2)(A) may not be applied to oral statements of financial condition. *Id*.

1. The Representations, and Falsity

The personal and corporate financial statements that the Defendant tendered to Vilenchik contained multiple representations as to the Defendant's and his companies' ownership of tangible and intangible assets and his and his companies' liability on indebtedness. These representations were material to any evaluation of MSO's application for credit, given his offer to stand good on MSO's debt by using assets he personally owned or that he had under his control. The Plaintiff characterizes as false various entries on these documents. It claims that the Defendant's tender of their information to Vilenchik was a fraudulent misrepresentation to induce it to make the loan.

In its original briefing, the Plaintiff relied on the following written content as fraudulent: (1) the balance sheet and income statements for LandCor and LCCI, said to be "not accurate and complete," with a misstatement in their recitation of accounts receivable for those companies because they were "never available for repayment of the loan"; (2) the content of the rent roll for MSO Building B, said to be "inaccurate and overstated and . . . rents from tenants were misapplied"; and (3) the overall statement of the Defendant and his companies' "personal financial condition," said to be "grossly misrepresented" due to the omission of "approximately $40,000,000.00 in undisclosed debt and related liabilities."

These were the statements in writing pleaded originally as the basis of the Plaintiff's action for fraud. Adversary Complaint to Avoid Discharge [sic] [Dkt. No. 1], 4. The treatment of the Plaintiff's request for judgment and nondischargeability as to fraudulent statements in written form will be limited to them.[25]

Of these points, two fail to qualify as a false representation for want of sufficient evidence. One does qualify.

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[25] In post-trial submissions, the Plaintiff's counsel sought findings and adjudications on twice as many other alleged written representations, plus alleged omissions of other material information. Plaintiff's Proposed Findings of Fact and Conclusions of Law [Dkt. No. 50], 31. By this ploy, counsel again exceeded boundaries. These points were never put into contention on formal or proper notice to the Defendant, by pleading and pretrial briefing. Thus they were not even in suit.

First, there is far too little evidence of record to support findings on the full narrative that the Plaintiff advanced, as to the falsity of the representations regarding the value of intangible assets (accounts receivable) held by LandCor and LCCI.[26] These alleged assets are identified as "accounts receivable" on the "LCI and LCCI Consolidated Balance Sheet," dated September 30, 2008 [Exh. 22]. Their stated value is $3,433,521.91. The Plaintiff characterizes them as false. The accusation is that these references were rationalizations, reflecting only inter-company liabilities within the Defendant's generally-foundering enterprise structure, or projected rights to payment that were not enforceable and never became collectible. It also claims falsity on the asserted ground that all of the LandCor and LCCI accounts receivable were, in reality, fully encumbered in favor of GCI Capital.[27]

However, the Plaintiff's only evidentiary submission toward a "true" state of affairs came from its lawyer's blunt but brief haranguing of the Defendant on examination as an adverse witness. The results of that were inconclusive as to the makeup of the LandCor/LCCI receivables (i.e., whether they were owing by bona fide third-party obligors, or only resulted from inter-company transactions not capable of repayment due to the enterprise's deteriorating posture). As to the alternative, the Plaintiff's counsel never even asked the Defendant about the asserted, all-encumbering lien in favor of GCI Capital. Nor did he prove it up with documentation from loans by GCI Capital to any of the Defendant's companies.[28] The Plaintiff barely proved a representation, as to the subject matter; but it did not prove a *false* representation.

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[26]These apparently are the same receivables that the Defendant was said to have proffered as alternate recourse for the Plaintiff, capable of quick liquidation at the Defendant's action for payment to the Plaintiff.

[27]There is some inconsistency in the viability of these two accusations. If both were true, not only the Plaintiff, but GCI previously, would have lent on fabricated accounts receivable. This prospect is simply less likely to have been the case, from the simple multiplication of parties alleged to have been gulled over the same readily-discernible subject matter.

[28]A security agreement creating such a lien would have been the basis on which to establish that. The Plaintiff could not demand or lever any satisfaction from these assets, but that is all the testimony establishes. In its summary form, Vilenchik's brief testimony that he had later found out about such a lien lacked the requisite probity.

Second, the rent roll from the bank book [Exh. No. 25] does qualify as a representation of material fact, and a false one.[29] The whole narrative that the Defendant pitched to Vilenchik was premised on a picture of a commercial rental operation that had had a measurable start; was currently stalled due to a temporary interruption of capital; and just needed a kick-start of funding to push it forward. The semblance of two buildings with at least a modicum of leased-out space was essential to the credibility of the narrative. The Defendant clearly proffered the rent roll to evidence that. He explained the notations as follows: "available" signified a vacant space; "lease" or "leased" meant that "there [was] a signed lease." He did not really explain "LOI." It is reasonably clear that this signified only the giving of a "letter of intent" or some other opening expression of interest from a tenant, that was only prospective in orientation and subject to negotiation and final commitment.[30]

The recitation of spaces under "lease" in the bank book's rent roll is false. It identifies four individual parties with associated space under that rubric, three with two-suite spaces and the other with one suite. In point of fact, there were only two paying tenants on-site in Building B in September-October, 2008, and one in Building F, the retail-oriented structure.[31] Given its role in bolstering the oral statement of MSO's need for financing, this false representation went directly to a material fact.

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[29]This conclusion can be reached regardless of the partial garbling of the Plaintiff's proof. The Plaintiff introduced only a rent roll for Building B, the retail/office structure, toward establishing a written misrepresentation. None for Building F, the retail-oriented structure, was offered. Vilenchik opined that he was sure he had seen one, but explained the absence only by saying that he was offering all that he had in his possession.

[30]The Defendant's trailed-off reference in testimony to "if there were contingencies on the lease," came almost immediately after this explanation. It suggested a similarly tentative, early stage in marketing a space to a particular interested party.

[31]The actual rent rolls that MSO maintained internally effective September 8, 2008, were received as Plaintiff's Exhibit 7. The Defendant never testified to any increase in occupancy occurring over the next two months. In any event, the Defendant contradicted himself on the matter of actual tenant occupancy as of October, 2008, in his testimony at trial. Early on, he stated MSO had four to five tenants between the two buildings, at that time. Later he stated that there were only two, being Cold Stone Creamery in Building F and a single tenant in Building B.

Third, the alleged understatement of the Plaintiff's personal liabilities on his personal financial statement fails to qualify as false. The reason is simple: the small amount of evidence lacked any detail to bear out the vast insolvency that the Plaintiff alleges to have been the truth when the Defendant gave Vilenchik his financial statement. This proof came solely in the form of testimony and only from the cross-examination of the Defendant. The Plaintiff's counsel summarily confronted the Defendant about a handful (three or four) of the creditors identified in his personal bankruptcy schedules as holding contingent claims against him, on account of credit granted to his other companies and ventures. In response, the Defendant could offer very little. He professed insufficient memory, and he asserted his reliance on bankruptcy counsel's advice to schedule any and all possible claimants against him, no matter how remote the basis for personal liability.

To make out falsity in these recitations or omissions, the Plaintiff truly had to prove a large negative. Documentary corroboration (evidence of co-maker or guarantor status on such third-party obligations, for instance) would have been a start toward proving such undisclosed indebtedness. That was never offered.[32]

On such a paltry record, it is not possible to find that the debits on the Defendant's personal financial statement were so understated as to falsely depict a substantial personal net worth, contrary to a large insolvency in fact. These line entries do not qualify as a false representation cognizable for common law liability.

2. Defendant's Knowledge of Falsity

The Defendant sometimes waffled on the witness stand as to his memory of relevant events. Despite that, there is no reasonable dispute that he knew that MSO had only two, perhaps three paying tenants on-site when he proffered to Vilenchik the falsely-worded rent roll that showed more. He was acutely aware of the whole project's dreadful shortfall in revenue generation--gross rents of only $9,000.00 per month for both buildings, not even sufficient to service five days' worth of interest accrual in favor of CGI Capital. He was scrambling to get "LOI"-designated prospects

[32] Ultimately, the Plaintiff did not even offer the Defendant's bankruptcy schedules into evidence.

closer to committing to lease, but he was not having success. As he testified, in October-November, 2008 such parties were having trouble finding credit for their own start-up capital, the times being what they were becoming. He was trying to locate other prospective tenants for sales pitches. But, there was no doubt that he knew the actual state of affairs, a materially thinner rental operation than depicted. He therefore knew that the rent roll for Building B was false.

3. Defendant's Intent to Induce

The Defendant submitted that rent roll to Vilenchik as part of the "bank book," in his standard procedure for soliciting credit. He knew that this was precisely the sort of document that a lender would want when expecting repayment from a stream of net revenues from property operation, or from real property collateral with value that premised on the ability to generate such revenues. The use of the rent roll in that submission enables the inference that the Defendant intended to have Vilenchik rely on the rent roll as part of his decision to extend credit on behalf of the Plaintiff.

As observed earlier, the statement of the party's status on rent-up played an additional role in inducement, reinforcing the Defendant's representation regarding the need for the loan. As an experienced manager of rental operations and a developer who parlayed completed commercial developments toward sale in the market, the Defendant knew this sort of information would factor into the evaluation.[33] It follows by inference that he intended Valenchik to rely on it, and to extend credit on an attribution of credibility to his narrative. There is no intervening basis for doubt. The Plaintiff has satisfied the third element for this written representation.

4. Reliance

The same considerations on Valenchik's reliance apply for this written misrepresentation, as applied to the broader oral misrepresentation as to the need for the loan.

The Defendant takes Vilenchik to task for not making an interior inspection of the two buildings. The clear insinuation is that Vilenchik would have seen only two or three spaces with

[33] The Defendant would not have included the rent roll in his initial proffer, otherwise.

signage and in actual occupancy, and hence would have seen through the inaccuracy of the rent roll.

However, this argument is belied by the principles of justifiable reliance. The disjunction between the argument's implications and the underlying purposes of the law of intentional tort (fraud) is even wider here than it is for the oral misrepresentation. The Defendant presented the rent roll for Building B as an organized recapitulation of tenant identity, space size and location, gross rent, and all other fiscally-related detail for a relationship under a commercial lease. The format was comprehensive on its face. The document promised to be useful, both internally (to the Defendant's operation) and externally (to other prospective tenants, potential lenders, governmental authorities, etc.). Its content was presented with the verisimilitude that would inspire a recipient's confidence in MSO, and that would minimize doubt about the Defendant's professionalism and veracity. Yes, the document did depict a development-in-process, not yet completed; but there was nothing on its face to suggest that its representations of actual tenant occupancy were false.

More specific to the actual events, the Plaintiff cannot be faulted for Vilenchik's failure to demand entry to the building during the external inspection, considering the circumstances of that visit only. Vilenchik testified that he was satisfied from the visit, having concluded that the project looked orderly and well-managed from the buildings' exteriors and the grounds. The Defendant's lawyer did not challenge Vilenchik's confidence in his own conclusions on such points, which Vilenchik attributed to his personal experience in overseeing the build-out of tenant improvements. Nor did the Defendant's lawyer offer any evidence that exterior conditions at the time suggested occupancy lesser than represented in the rent roll. Vilenchik admitted seeing a need for further tenant improvements, even from the outside; but that was consistent with the Defendant's representations.

There was nothing from the face of the document itself, in any other written submission, in the Defendant's oral representations, or in the appearance of the buildings from the outside, that suggested that the rent roll for Building B was inaccurate in any way. The Plaintiff's fraud-structured claim on the falsity of the rent roll is not defeated, merely because Vilenchik failed to demand corroboration of its entries. The Plaintiff justifiably relied on the rent roll in determining to extend credit.

5. Resultant Damage

The very same analysis applies to the written misrepresentation, as applied to the oral misrepresentation as to the need for the loan. The Plaintiff has proved up the remaining element of fraudulent misrepresentation for the written misrepresentation previously identified.

6. Outcome

Whether the written misrepresentation within the rent roll is considered in its own right, or as a cumulative misrepresentation to bolster the actionable oral misrepresentation, the Plaintiff has satisfied all five elements of fraudulent misrepresentation premised upon the Defendant's use of it to obtain the loan from the Plaintiff. This is a separate ground on which the Defendant is liable in damages to the Plaintiff for fraudulent misrepresentation, under Minnesota law.

C. Liquidation of Debt

At trial, there was no significant controversy over the amount of the Plaintiff's damages. The Defendant did not contest that the Plaintiff's damages for fraudulent misrepresentation are measured by the principal amount of the loan plus the accrued interest provided by the note.

The principal amount of the debt owing by MSO was $500,000.00. After the debt became due in January, 2009, the Defendant made a half-dozen small payments that were applied to accrued interest alone. After June, 2009, no payment was made on the debt at all. The principal has never been reduced.

The Defendant did not object to the Plaintiff's calculation of the full amount owing, or to its proffer of a summary of principal plus accrued interest through April 23, 2012: $752,588.20. The Plaintiff is entitled to recover further accrued interest from then to the date of judgment, at the contractual rate.

As a matter of nonbankruptcy (Minnesota state) law, then, the Plaintiff is entitled to a judgment for recovery of money from the Defendant.

II. Dischargeability of Adjudged Debt.

In a much-quoted maxim, the relief of discharge in bankruptcy is for the "honest but unfortunate debtor." *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998). Substantive bankruptcy law has a number of measures to give effect to that precept. Among them is exception from discharge, the carving-out of particular debts from the discharge. Exception from discharge is governed generally by 11 U.S.C. § 523(a). Several parts of that section redress a debtor's wrongdoing in the creation of particular liability for debt. The Plaintiff has invoked two of these provisions, the alternatives under 11 U.S.C. § 523(a)(2).

A. 11 U.S.C. § 523(a)(2)(A): False Pretenses, False Representation, or Actual Fraud

11 U.S.C. § 523(a)(2)(A) provides for an exception from discharge for "any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition . . . ." This provision "prevents persons from committing actual fraud and then wiping away their resulting debt." *In re Miller*, 276 F.3d 424, 429 (8th Cir. 2002).

In this circuit, the elements of a creditor's proof under § 523(a)(2)(A) are identified as:

1. The debtor made a representation.
2. The debtor knew the representation was false at the time it was made.
3. The representation was deliberately made for the purpose of deceiving the creditor.
4. The creditor justifiably relied on the representation.
5. The creditor sustained the alleged loss as a proximate result of the representation having been made.

In re Freier, 604 F.3d 583, 587 (8th Cir. 2010) (citing *In re Ophaug*, 827 F.2d 340, 343 (8th Cir. 1987), *as modified by* 516 U.S. 59, 74-75 (1995).

Thus framed, these elements are essentially identical to those of fraudulent representation under Minnesota law. This is no accident. The Supreme Court has held that the terms of § 523(a)(2)(A) are construed "to incorporate the general common law of torts, the dominant consensus of common-law jurisdictions . . . ." *Field v. Mans*, 516 U.S. 59, 71 n.9 (1995).[34] The Eighth Circuit has observed that "Minnesota law [on intentional fraud] is consistent with the consensus of common-law jurisdictions." *In re Freier*, 604 F.3d at 588 n.2.

With that overlap in the terms of governing law, there is not that much to discuss as to the dischargeability under § 523(a)(2)(A) of the Defendant's adjudged, tort-premised debt to the Plaintiff. Because the specific syntax of the two jurisdictions' tests varies a bit, it is worth explaining two things.

First, the "deliberate[ ]" state of mind, harboring "the purpose of deceiving the creditor," as the Eighth Circuit frames the intent requirement, is the same as an intent to induce the creditor to change position, to grant "money, property, services, or an extension, renewal, or refinancing of credit" to the debtor, by making the misrepresentation. This equation was first articulated within this district in *In re Gibson*, 149 B.R. 562, 572 (Bankr. D. Minn. 1993). It dovetails with the sense of the Eighth Circuit's ruling in *In re Glen*, 639 F.3d 530 (2011), that the harm to the creditor (the giving of money, property, or credit to the debtor) must have occurred "concurrent with," and as a direct consequence of, the challenged misrepresentation; and the misrepresentation must have been made by the debtor to the creditor that suffered the harm. 639 F.3d at 533. A creditor is not required to prove a more wide-ranging scheme on the part of the debtor, or to prove actual ill-will or malice on the debtor's part. *In re Gibson*, 149 B.R. at 572.

Second, the nature of the creditor's reliance essentially coincides, in the conception of the Minnesota Supreme Court and the federal appellate courts. In construing § 523(a)(2)(A) to

[34] The Eighth Circuit had previously espoused this approach. *In re Dallam*, 850 F.2d 446, 449 (8th Cir. 1988).

incorporate *justifiable* reliance as an element, the Supreme Court rejected "the application of a community standard of conduct to all cases." *Field v. Mans*, 516 U.S. at 71. Rather, "[j]ustification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case . . . ." *Id*. This does "require[ ] [the plaintiff] to [have] use[d] his senses," and it may bar recovery on an alleged misrepresentation for want of proper reliance where "the falsity . . . would [have been] patent . . . if [the plaintiff] had utilized his opportunity to make a cursory examination or investigation." *Id*. (quoting with approval Restatement (Second) of Torts § 541, Comment *a* (1976). However, such threshold vigilance clearly applies only to the immediacies of the representation and the proposed deal, plus whatever the creditor already knew about the subject matter on his own, from extrinsic sources:

> [i]t is only where, under the circumstances, the facts should be apparent to one of his knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived, that he is required to make an investigation on his own.

Id. (quoting with approval, W. Prosser, Law of Torts § 108, p. 718 (4th ed. 1971)). The creditor's own intelligence, experience, and general knowledge are relevant to the determination of justifiability. But, unless falsity would be "patent" to the view of a person of comparable sophistication, faced with the same representation and on the same extrinsic knowledge, recovery cannot be denied on the ground that the reliance was not justified. *Field v. Mans*, 516 U.S. at 71; *In re Freier*, 604 F.3d at 588. *See also In re Ungar*, 633 F.3d 675, 679 (8th Cir. 2011).

These pronouncements all strongly align with the Minnesota Supreme Court's rulings, particularly the most recent articulation in *Hoyt Properties, Inc. v. Prod. Res. Grp., LLC*. For both forums, the issue is classified as one of fact. *In re Freier*, 604 F.3d at 587; *Hoyt Properties*, 736 N.W.2d at 321.

With particular reference to the standard for dischargeability, a couple of extra points are important.

First, the Supreme Court expressly endorsed an illustration for the concept of justifiability that appears in the Restatement; and, resonating with the matter at bar, that one went right to the situation of real estate with a value impaired by unsatisfied, liened-in debt: the reliance of a buyer on a seller's representation of free-and-clear status would be justifiable, even if the buyer could have readily found an unsatisfied mortgage in the public land records. *Field v. Mans*, 516 U.S. at 70.[35] Then the very next pronouncement reinforces the conclusion, with reference to the contrasting bases of different theories of liability and their policy underpinnings: to deny recovery to a plaintiff because it had not further investigated on its own motion and without prompting, would inappropriately apply the bar of contributory *negligence* to a wrong governed by the law of *intentional* tort. *Id*.[36]

The defense here insisted there had been numerous means through which the Plaintiff could have uncovered the over-encumbered and defaulted status of the MSO project and its financial instability. Such means included contacting GCI Capital to ascertain the status of the preexisting debt, the senior mortgage, and the frozen line of credit; doing an interior inspection of the two buildings; requiring documentary verification of the contemplated cost of tenant improvements, and control over disbursements toward them; and demanding documentary verification of the assets proposed as secondary sources of repayment. The Defendant would have the Plaintiff fatally faulted for not taking them, and denied the relief of nondischargeability.[37]

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[35]Presumably, this example presupposes no extrinsic knowledge on the buyer's part, and no visible evidence of encumbrance at the property.

[36]The unspoken reason beneath the mismatch is that redress for intentional tort focuses on the defendant's wrongdoing, rather than the plaintiff's action, and the different bodies of law for negligence and intentional tort are channeled according to corresponding notions of the justness of relief. Four years before the issuance of *Field v. Mans*, this principle was deftly and incisively recognized locally--though in the context of litigation under § 523(a)(2)(B). *In re Richards*, 72 B.R. 1017, 1021-1022 (Bankr. D. Minn. 1987).

[37]This argument was made as a hedge against the adoption of the Plaintiff's factual theory as to the representations made. It does not logically fit with the Defendant's theory for the representations--which had the Defendant fully disclosing to Valenchik that MSO was under a forbearance arrangement with GCI Capital; was significantly in default on current interest payments; needed the money to make the cure and for no other purpose; and had expressly threatened GCI Capital with a Chapter 11 filing earlier in the year, to no avail on the matter of restructuring the debt.

Vilenchik did not take these means, but that does not make his reliance on the Defendant's representations unjustifiable.

Here is where the very content of the representations is important. That content played a key role in reinforcing a dynamic toward acceptance on the part of the Plaintiff. Early in their contacts, Vilenchik voiced the Plaintiff's reluctance to lend on the security of a second mortgage, i.e., on the value of real-property collateral but from the impairment of a subordinated position. With all of the Defendant's various, cumulating blandishments and proffers, Valenchik's resistance lessened. And even though Valenchik testified to relying heavily on asset value as part of his determination, his full testimony makes it clear that he decided on behalf of the Plaintiff to loan to MSO because he saw a sufficiently-reliable prospect of timely repayment from the specific means that the Defendant proposed via his misrepresentations. The represented means were the loosening of the GCI Capital credit facility by a resumption of the active leasing of space by MSO. Through the Defendant's application and the discussion, Vilenchik became willing to commit the Plaintiff to this risk, on an evaluation that took material account of the content of the misrepresentations.

In this light, the supposed "red flags" waved by the defense do not defeat the Plaintiff's case for justifiability. The Defendant's counsel used accusatory phrasing for the circumstances that he impugned as facially suspicious: all of the Defendant's businesses were closely-held, somehow casting doubt on their stated values ("millions of dollars in value of securities for privately-traded [sic] and related businesses," "equity in real estate owned through his businesses"); any conclusions of substantial future income from the Defendant's full enterprise had to be considered bogus ("$5,000,000 in future contingent income"); and the Defendant had large problems with taxing authorities evidenced by the returns submitted to Valenchik ("in excess of $300,000 in income tax liabilities. . . that was [sic] significant personal income tax liabilities outstanding").

Much of the phrasing for these points in brief and oral argument was disingenuous. The Defendant never did prove up the existence of an actuality that matched the magnitude of such baleful indicia.[38]

But in any event, this whole line of attack ignored the real point, an application for credit to *one* entity, for *one* stated purpose, under a coherent if terse narrative. That narrative made facial sense, once the Defendant's stated premises were accepted; and it ultimately seemed to match to a level of risk that Valenchik was willing to assume on behalf of the Plaintiff. Valenchik did enough external investigation. It was more than nothing, and certainly went to the relevant: obtaining personal credit reports for the Defendant and his wife, and a title search for the subject property. None of the results contradicted the whole pretense that the Defendant was projecting: he had had large success in making money in a competitive industry, and responsibly managing large amounts of debt, and the public land records showed no signs of deeper financial distress in the property and project in question.[39]

Certainly, Valenchik could have done more to vet the Defendant's application, even after the gauging assurance of short-term repayment that he concluded was adequate. But ultimately the fact that he did not do so does not make his reliance unjustifiable. He did not testify in any detail to previously evaluating applications for financing for similar purposes on behalf of the Plaintiff. But, he had had some prior experience in overseeing tenant improvements in a commercial setting and had evaluated creditworthiness on loans of substance. He had been engaged as the decision-maker for a privately-capitalized residential and commercial lender for several years, during times that were busy in the real estate sector. Those boom times were crashing to a close even as

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[38]The analysis here is limited to the smaller number of alleged inconsistencies that counsel identified in pre-trial briefing or singled out for treatment in the proposed findings and conclusions submitted in lieu of closing argument. There may have been other points possibly to be characterized as red flags scattered throughout the sprawl of the record. However, it was incumbent on the defense to put them expressly before the court for ruling by specification and developed legal argument.

[39]Mechanic's and materialman's liens only appeared of record after MSO defaulted and Valenchik updated his title search.

the Defendant was approaching the Plaintiff, but Valenchik did not act with any less prudence in evaluating the Defendant's application than his prior experience would have suggested.

And, the element of justifiability is measured against Vilenchik's savviness *in fact*, not against a hypothetical and higher standard. The record reflects that the Defendant was significantly more adept at getting financing of this specific sort, than Vilenchik was in thoroughly evaluating whether to give it. That had to have been apparent to the Defendant--even if, it seems, Vilenchik did not realize the discrepancy in sophistication. It would be overstating the case on flawed and incomplete evidence, to say that the Defendant took advantage of Vilenchik in a predatory way. But there is no doubt that the Defendant parlayed his greater experience against Vilenchik's lesser, through a short process of vetting, and got pretty much what he wanted. In passing on justifiability, the court may consider the relative sophistication of the parties, and the degree of the creditor's past acquaintance with the subject matter of the representations, as well as any extrinsic, preexisting trust in the debtor. *In re Ungar*, 633 F.3d at 679.

And it cannot be ignored, that MSO desperately needed the money.[40] This was obvious, even under the predicates of the Defendant's own narrative. The debt here was created when a creditor, the Plaintiff, accommodated MSO, and extended itself to ease that desperation. The focus of nondischargeability is on debtor wrongdoing, just as is the law of intentional tort. Given that, and the Defendant's knowing use of a lie, it is not at all merited to discharge this debt by faulting Valenchik's actions. The specific process that he went through to gauge the likelihood of repayment per terms, on the specific proposal and predicates that the Defendant proffered, was not

[40]The desperation was reflected in the sort of dissembling that the Defendant was engaged in contemporaneously, in his communications with O'Brien. Among other things, he was using the terms "investment" and "investor" in making otherwise-opaque and anonymous references to the prospect of getting a *loan* from the Plaintiff. He was grossly overstating the progress and firmness of the prospects of recapitalization through his nascent contacts with the DeWaay brokerage. Later, he failed to disclose to GCI Capital that he had taken the loan from the Plaintiff, in breach of a contractual duty to GCI Capital. The Plaintiff's counsel was bent on getting these things into the record, probably hoping to get the Defendant adjudged liable more for being a bad person, or a liar through-and-through. Toward those purposes these points were not material. But they were relevant to the fact issue of how dire MSO's straits were, and how the Defendant was reacting to that.

inappropriate. Valenchik's reliance on the Defendant's representations, oral and written, was justifiable under all circumstances.

The defense's argument on causation for dischargeability purposes is defeated by the earlier rulings on the same issue in the context of liability. Further, adopting the principles urged with such stridence could only be justified on an unwarranted imposition of the bar of contributory negligence.

Thus, by the same proof that established the Defendant's liability under nonbankruptcy law, and under the same findings, the Plaintiff has established that the Defendant's debt is excepted from discharge under § 523(a)(2)(A).

B. 11 U.S.C. § 523(a)(2)(B):
False Statement Respecting Financial Condition

The elements of a "false financial statement" under 11 U.S.C. § 523(a)(2)(B) are enumerated in the statute: a debt is to be excepted from discharge if it is

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, 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 . . . .

Here, the potential "statement in writing . . . respecting the debtor's or an insider's financial condition" has been winnowed down to the falsely-postured rent roll. The treatment of this alternate theory of nondischargeability is easier, as a result.

First, the rent roll does qualify as an actionable "statement in writing." MSO was an insider of the Defendant. 11 U.S.C. § 101(31)(A)(iv) (where "the debtor is an individual," a "corporation of which the debtor is a director, officer, or person in control" is an insider of the debtor). Yes, the rent roll was not a structured balance sheet itemizing all assets and all debts, for either MSO or the Defendant. But that does not prevent it from qualifying under § 523(a)(2)(B)(ii), as long as it contained material information respecting financial condition. *First Nat'l Bank v. Pontow*, 111 F.3d at 609 (affirming bankruptcy court's ruling that borrowing base certificates submitted by debtor to justify continuing draws on line of credit were within scope of § 523(a)(2)(B), even though they were not comprehensive balance sheets showing debtor's net worth); *In re Long*, 774 F.2d 875, 877 (8th Cir. 1985) (written statements regarding value of inventory were statements respecting debtor's or insider's financial condition under § 523(a)(2)(B)). The rent roll had such content. The representation of a development partially-leased to current tenants and subject to negotiations for more, was material to a proposal for credit that was to enable such further leasing.

The findings made for the Plaintiff's state-law claims apply directly to this theory of dischargeability, as they pertain to the Defendant's use of this written statement. Those findings satisfy §§ 523(a)(2)(B)(i), (ii), and (iv) in full, and (iii) in part.

The only element of § 523(a)(2)(B) that merits discussion is Vilenchik's reliance. His actual reliance is established by the earlier findings. The question is whether that qualifies as "reasonable." This standard differs from that under § 523(a)(2)(A), from the very face of the statute, and it is to be given its own effect. *Field v. Mans*, 516 U.S. at 64-69.

In earlier jurisprudence under § 523(a)(2)(B), some courts construed the notion of "reasonableness" in reliance as requiring an inquiry into compliance with general industry standards for the review of statements of financial condition, at least where the creditor was an institutional lender or otherwise was engaged in offering credit to the public.[41] *In re Kerbaugh*, 162 B.R. 255, 265 (Bankr. D. N.D. 1993); *In re Iverson*, 66 B.R. 219, 226 (Bankr. D. Utah 1986); *In re Reder*, 60 B.R. 529, 537 (Bankr. D. Minn. 1986); *In re Harms*, 53 B.R. 134, 141 (Bankr. D. Minn. 1985); *Matter of Patch*, 24 B.R. 563, 567 (D. Md. 1982). The Eighth Circuit has not gone that far. However, it has outlined the scope of the inquiry, a totality-of-the-circumstances approach. And, it has identified at least two circumstances that must be considered, both of them external to the creditor's act of actual reliance:

> . . . 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.

In re Jones, 31 F.3d 659, 662 (8th Cir. 1994) (quoting *In re Coston*, 991 F.2d 257, 261 (5th Cir. 1993) (en banc) (interior quotations omitted). *See also First Nat'l Bank v. Pontow*, 111 F.3d at 610 (citing *Jones* and addressing same considerations).

"Red flags" are manifestations of possible falsity or incompleteness that appear from inconsistencies or incongruities on the face of the writing or are otherwise known from extrinsic sources. The judicially-framed standards for both justifiable and reasonable reliance require red flags to be considered. However, under the articulation for reasonableness adopted in *Jones*, a complaining creditor is under a different onus as to the taking of further steps. The reasonableness standard imposes more of an obligation to investigate on the recipient of a written statement of financial condition, than the justifiability standard does on the recipient of an oral representation, before the creditor-recipient can claim to have been blindsided through its reliance.

As adopted in *Jones*, the formulation from *In re Coston* has the two considerations in the conjunctive (i.e., using the connector "and" rather than "or"). It voices the second consideration in the hypothetical (i.e., whether "even minimal investigation *would have* revealed the

[41] This dovetails with the notion of "reasonableness" being an objective standard, i.e., measured against standards that a hypothetical "reasonable" creditor would apply to govern its conduct.

inaccuracy . . ."). That wording must be given significance. Under it, a court must consider whether "minimal investigation" would have revealed the falsity in the content or the proffer. If it would have, and the creditor did not perform the investigation, the creditor was not reasonable in relying on the writing alone for the subject matter of its content, if the information was material to a determination on creditworthiness.

With the two considerations voiced in the conjunctive, a creditor complaining under § 523(a)(2)(B) must prove up both before it can establish reasonable reliance--i.e., a lack of inconsistencies, facially non-credible recitations, material omissions, and the like within the writing and from all else the creditor knew at the time; *and* the *performance* of at least a "minimal investigation" of the writing's entries.

On the findings at bar, Vilenchik's reliance on the MSO rent roll as a statement of financial condition fails the reasonableness element.[42] The failure comes from the requirement of investigation.[43]

To the extent that Vilenchik expected to rely on the rent roll as part of a comprehensive picture of MSO's financial state, there were perfectly easy ways to verify its recitations and to validate the depiction of MSO as momentarily hobbled but capable of getting a critical mass of sustainable tenant base. The most minimal means would have been a demand for copies of all signed written leases for the entities identified in the roll as leasing tenants. Barely more demanding would have been an interior inspection during Vilenchik's site visit. A more

[42]The evidence does support the inference that Vilenchik actually relied on it as to its subject matter, and that finding is made. As noted earlier, the rent roll did look regular on its face. Its content fit right into the larger pretense that the Defendant was projecting, as to the need for the financing and MSO's potential for completion and financial soundness. Vilenchik bought into that pretense in deciding to lend to MSO. There was no dissonance between the content and "the limits of the reasonable," against surrounding circumstances. *Field v. Mans*, 516 U.S. at 76. So, actual reliance was proven. *Cf. In re Keim*, 236 B.R. 400, 403 (B.A.P. 8th Cir. 1999) ("hand-scribbled rough draft of an incomplete . . . statement," "materially and obviously incomplete and ambiguous," is not capable of reasonable reliance).

[43]The Plaintiff's case passes muster, as to a lack of red flags. The format of the rent roll is detailed and professional in appearance, and seemingly comprehensive. Its content-recitations are consistent internally. Valenchik was not made aware of any state of affairs affirmatively to the contrary from any extrinsic source, before he disbursed the loan proceeds to MSO, i.e., nobody informed him there might be less than the stated number of tenants in occupancy under lease.

comprehensive tour of the premises would have suggested lower occupancy than represented in the roll. The roll's specific veracity and the credibility of the Defendant's whole pretense would have been called into question. Vilenchik also could have contacted tenants on-site and those identified in the roll, to directly verify their status with MSO. Even more appropriately, he could have contacted the ostensibly-prospective tenants designated as "LOI," to determine whether they were ready and able to move in once MSO completed their tenant improvements.

Valenchik did not do a bit of that. He just took the rent roll's recitations at face value. The rote investigation that he did covered the hard collateral's status on title and encumbrances, and bore on the Defendant's own trustworthiness as evidenced by past management of substantial debt obligations and similar business operations. Neither of those went to the financial health of MSO's leasing operation at that time, however, or to the specific proposal for bolstering and bettering the operation. As to those, Valenchik just took the rent roll at face value, in reinforcement of oral representations that proved to be false. He should not have done that.

So, the Plaintiff's case for nondischargeability under § 523(a)(2)(B) fails, even though the Defendant is liable for fraud under nonbankruptcy law for his use of the rent roll in inducement of the Plaintiff. It failed because the prima facie case required under § 523(a)(2)(B) is facially more exacting than is the case under the Minnesota law of fraudulent misrepresentation and under § 523(a)(2)(A).[44]

III. Conclusion

The scattershot approach of the Plaintiff's pleading, litigation, and proof at trial created a complicated, tangled, and confusing body of evidence in argument to treat when the merits

[44]The outcome is that the Plaintiff is less penalized for Valenchik's lack of suspicion when § 523(a)(2)(A) is applied, than it is in application of § 523(a)(2)(B). This may seem perverse; the former statute applies to oral representations of fact--a form inherently more problematic of proof after the fact and thus less to be taken without question and at face value at the time of proffer into evidence. The distinction, however, is a product of Congress's specific choice in framing the two provisos, the one incorporating common law standards and the other embodying a tougher and more uniform statutory test. The statutory distinction may have been prompted by Congress's recognition of a specific sort of abuse, one that seems to be absent from the dispute between these parties. *Field v. Mans*, 516 U.S. at 76-77 and n.13. Nonetheless, the statutes must be applied, separately and as they stand.

had to be addressed. Most of the Plaintiff's component-theories for imposition of liability and nondischargeability failed. In no small part, that failure traces back to Valenchik's ineptitude in initiating this credit. Nonetheless, it was clear that the Defendant had parlayed a lie to get something for his company that he knew it likely would not qualify for--half a million dollars of credit he desperately wanted but that had no significant assurance of providing a lifeline for his foundered real estate development.

The defense argued strenuously to leave the onus of this failure on the Plaintiff, by impugning Valenchik as the self-creator of his employer's own disaster. The defense would have Vilenchik alone held to task, for failing to uncover the Defendant's wrongdoing. That pitch elided the causative role of the Defendant's lie. MSO was already headed toward likely failure, but the Defendant's misrepresentation pulled the Plaintiff into the zone of damage.

The Plaintiff cannot escape all consequence for Valenchik's actions. The way Vilenchik handled the initiation of this credit placed his employer squarely into MSO's foundering. The brevity of Valenchik's pre-loan evaluation and the deficits of the Plaintiff's documentation for its own lending created vexing and complex issues, when greater care on his part would have better contained the risks and lowered the costs.

However, the Plaintiff has borne a consequence of that, a long and costly effort toward vindication in this litigation. It should not lose the legal foundation for recovering the benefit of its bargain as lender, which would occur upon discharge of the debt. The ameliorative function of bankruptcy relief is not to extend to debtors who engage in wrongdoing of the sort that the Defendant committed.

On the memorandum of decision just made, and on the rulings in the order on the Defendant's motion for summary judgment [Dkt. No. 20],

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED:

1. The Plaintiff shall recover from the Defendant the sum of $752,588.20, plus interest at the contractual rate of 14% from April 23, 2012 to the date of judgment herein, as its damages caused by the Defendant's act of fraudulent misrepresentation.

2. The Defendant is not liable to the Plaintiff on any other ground or on any other legal theory.

3. The debt evidenced by Term 1 was excepted from discharge in BKY 10-50165, by operation of 11 U.S.C. § 523(a)(2)(A).

4. 11 U.S.C. § 523(a)(2)(B) did not lie, so as to except the debt evidenced in Term 1 from discharge in BKY 10-50165.

LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT:

/e/ Gregory F. Kishel

GREGORY F. KISHEL
CHIEF UNITED STATES BANKRUPTCY JUDGE