§523(a)(2)(B)

PRESLEY, ELVIS

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

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In re:

PAUL R. NEW,

Debtor.

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THE HIGHLAND BANK,

Plaintiff,

v.

PAUL R. NEW,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER FOR JUDGMENT

BKY 3-86-1326

ADV 3-86-210

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At St. Paul, Minnesota, this 3d day of September, 1987.

This adversary proceeding came on before the undersigned United States Bankruptcy Judge for trial on August 19, 1987. Plaintiff appeared by its attorney, Jay R. Naftzger. Defendant (hereinafter "Debtor") appeared personally and by his attorney, Steven H. Berndt. Upon the evidence adduced at trial, post-trial written argument, and the other files and records in this adversary proceeding, the Court concludes that Debtor's debt to Plaintiff is not excepted from discharge in bankruptcy.

FINDINGS OF FACT

Debtor filed a voluntary petition in bankruptcy in this Court on May 7, 1986. His Chapter 7 case is presently pending.

On his Schedule A-3 Debtor included an entry for a debt in favor of

NOTICE OF ENTRY AND FILING ORDER OR JUDGMENT
Filed and Docket Entry made on SEP 3 1987
Timothy R. Walbridge, Clerk By

Plaintiff in the scheduled amount of $11,490.03, which is the subject of this adversary proceeding for determination of dischargeability. The debt is evidenced by a judgment entered in the Minnesota State District Court for the Second Judicial District, Ramsey County, on September 27, 1985, in the amount of $11,781.36.

Notwithstanding his possession of a bachelor's degree in business administration, Debtor has supported himself as a full-time professional musician since 1958. For at least the past ten years, his major act has been the performance of impressions of the late Elvis Aaron Presley, a singer and musician of some prominence in the history of American popular culture. From the late 1970's through the mid-1980's, he staged, produced, and performed under the banner-name of "A Tribute to Elvis." The shows varied in degree of size and lavishness. For at least several years, he made a very substantial income from his musicial career.

Toward his goal of reproducing the original Presley stage presence as closely as possible, Debtor hired various backup musicians and singers for his shows. During his search for backup musicians for a planned January, 1984 production in Minneapolis of his "Elvis Show," he met an individual named James Mueller in Brooklyn Park, Minnesota, during the 1983-4 holiday season. Mueller was a member of the Brooklyn Park Lions Club and a member of a singing group called The Decades. Mueller was also a loan officer with a Twin Cities-area bank at that time. Debtor hired The Decades to provide male backup vocals (in a style similar to that which the Jordanaires provided to Elvis Presley in the mid-1950's) for the January, 1984 show and later hired them for several more shows in the spring of 1984. Debtor, Mueller, and Mueller's group regularly rehearsed over four or five months in early 1984, and Debtor and Mueller became friends.

Based on the popularity and apparent quality of Debtor's productions, Mueller suggested the possibility of staging benefit concerts to support the "Drug Awareness Project" of the Lions Club. Debtor, Mueller, and various Lions Club members discussed a large-scale production of the "Elvis Show" for the summer of 1984 for this purpose. In February, 1984, Debtor and Mueller met with Lions from Northwestern Iowa and made arrangements for a two-night concert for the Drug Awareness Project, to be staged on August 16-17, 1984, at a fairground in or near Clear Lake, Iowa.[1] Debtor undertook to make arrangements for the staging of the show, which was to include a 21-musician band. He purchased a policy of liability and "rain insurance," the latter of which was to protect him from liability for the show's expenses and/or a loss of profit if the show were cancelled or if gate receipts were materially lessened due to rain. Debtor incurred obligations for out-of-pocket expenses for accommodations and staging in excess of $40,000.00. It rained heavily at the fairgrounds site on the day of the performance, flooding the grounds, but it did not rain during the scheduled times of performance. Attendance at the shows was substantially less than expected, and receipts were insufficient to meet expenses. Debtor was unable to meet all of the expenses from his own, his wife's, and his friends' investments in the show; the shortfall exceeded $10,000.00. He felt compelled to "make good" on the expenses. In Clear Lake after the show, Mueller told Debtor to come to see him at his bank office in the Twin Cities and said that Mueller "would try to help him."

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[1]Clear Lake, Iowa is of course the locality where Buddy Holly, Ritchie Valens, and J.P. Richardson a/k/a "the Big Bopper" met their untimely fate on February 3, 1959. The venue of the show is therefore probably not a coincidence.

Early the week following the aborted concerts, Debtor and Mueller met in Bloomington, Minnesota and discussed the possibility of Debtor's obtaining a loan from Plaintiff to cover his immediate liability for the remaining expenses. Mueller was by that time a loan officer with Plaintiff at its Bloomington branch. Debtor made Mueller aware of the existence of the rain insurance policy and his intent to make a claim under it. He also provided Mueller with a personal financial statement dated February 10, 1984. This statement was a photocopy of one which Debtor had prepared on a "Banco" standard form and given to a banker at Norwest Bank Camden in February, 1984, in connection with other credit transactions at that bank. Acceptance of such a dated financial statement was within accepted banking industry practice and within Plaintiff's standards for a loan of approximately $10,000.00. Mueller placed the financial statement in a file which he opened for the transaction.

Columnar entries in the financial statement which are relevant to this litigation include:

Cash in this Bank "average 500.78"	$1,000—
Cash in Other Banks (Detail)	
Bartlett State Bank	3,500—
Bartlett Savings & Loan & Money Market	50,000—
Securities Owned (Schedule 3)[2]	5,000—
Homestead (Schedule 5)[3]	92,000—

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[2]Schedule 3 described this as 150 shares of stock in Commonwealth Edison, registered in the names of "Paul & Nancy New."

[3]Schedule 5 alleged the title to the homestead to be "in Name(s) of Paul & Nancy New." Nancy New was then Debtor's wife. Schedule 6 alleged that the homestead was encumbered to one Delores Bobowiec in a balance of $17,000.00, payable at $350.00 per month.

Personal Property	
musical equipment	75,000—
jewelery [sic]	30,000—

It is undisputed that Debtor did not then, and never had, an account with Plaintiff. In February, 1984, he had loans and accounts at Norwest Bank Camden. It is also undisputed that the scheduled "cash in other banks" entries were attributable to deposits which Debtor's then-wife held in Illinois financial institutions in her name alone; that the entry for "homestead" was attributable to a Bartlett, Illinois residence which Debtor and his then-wife had lived in but which was titled in Debtor's then-mother-in-law; and that the entry for jewelry was attributable to various gold and turquoise craftwork belonging to Debtor's then-wife. At the time, Debtor had a vague belief that he had access to the Illinois bank deposits and the jewelry by virtue of his marital relationship to this then-wife, that he and his then-wife were the fee title owners on the Illinois homestead as "it had been given to [them] by" his then-wife's mother and they were actually occupying it; and that the true current sale value of his musical equipment was as stated.[4] He knew that the Illinois homestead was not subject to a mortgage. There is no strong evidence of record that the value of Debtor's musical equipment then owned by him was other than scheduled, though it is likely that it was less.

Receiving a loan from Plaintiff in the face amount of $10,019.03 on August 24, 1987, Debtor executed a promissory note for that amount in favor of Plaintiff. The loan was to bear interest at the rate of 16 percent per year and

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[4]Debtor's marriage was dissolved in the Illinois courts at some point in 1985 or 1986 and his wife was awarded virtually all of the assets which were located, or on deposit, in Illinois.

was due and payable in full on October 23, 1984. Within several days of the making of the loan, Mueller, acting in accordance with industry practice and Plaintiff's standards, prepared a "loan comment sheet" summarizing the terms of the loan and the basis on which it was made. In pertinent part, the loan comments note:

PURPOSE:	PERSONAL - business development
. . .	
EMPLOYMENT:	Self employed.
EXPERIENCE:	Have known for over one year.
ACCOUNT:	Will be opening development account.
REMARKS:	Will be paying in full with Rain Insurance check. I verified with the insurance company, documents are in file.

Unfortunately, Mueller did not testify at trial in this adversary proceeding. Plaintiff's only evidence on the issue of whether Plaintiff actually or reasonably relied on Debtor's February 10, 1984 financial statement was the testimony of its current President, Leroy Ashfeld, who commenced employment with Plaintiff on November 1, 1984, after Mueller made the original loan. Ashfeld was not involved in the making of the original loan and acknowledged that Mueller made the loan "on his own discretion," without having to seek, and without actually seeking, prior approval from any senior officer. Mueller did not attempt independent verification of the entries on Debtor's financial statement before making the original loan. Ashfeld did not testify as to the process by which Mueller determined Debtor's creditworthiness or his state of mind when he decided to make the loan to Debtor, and there is no evidence of record on these issues.

Even though Debtor did not pay the August 24, 1984 note when due, Mueller renewed the loan. The renewal is evidenced by a December 10, 1984 note

in Plaintiff's favor, in the face amount of $10,058.23, due and payable in full on March 11, 1985. Plaintiff did not produce loan comments or any documentation for this transaction other than the renewal note. Both the original and the renewal notes were unsecured.

Late in the fall of 1984, the company issuing the rain insurance policy for the Clear Lake shows refused to pay on the policy, apparently on the ground that the heavy rain had not occurred during the times when coverage was effective. Debtor hired a Minneapolis attorney, who pursued the matter without success until mid-1985. Debtor never received rain insurance proceeds and had insufficient personal income during 1985 to repay his loan from Plaintiff. Mueller resigned from his employment with Plaintiff at Ashfeld's request in March, 1985. Ashfeld made the request partly because of a "difference in lending philosophy," in that Ashfeld believed that Mueller had not exercised "good judgment" in his grants of credit. Debtor's and Mueller's friendship did not long survive Mueller's departure from Plaintiff's employ, though they continued to work together on musical productions through mid-April, 1985. Plaintiff sued Debtor in Ramsey County District Court on the defaulted note, obtaining a default judgment against him. The judgment was partially satisfied in a minor amount by garnishment and voluntary payments, prior to Debtor's bankruptcy filing.

CONCLUSIONS OF LAW

Plaintiff seeks to have Debtor's debt to it excepted from discharge in bankruptcy under 11 U.S.C. §523(a)(2)(B), which provides in pertinent part as follows:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—
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> . . .

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
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> . . .
>
> (B) use of a statement in writing—
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> (i) that is materially false;
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> (ii) respecting the debtor's or an insider's financial condition;
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> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
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> (iv) that the debtor caused to be made or published with intent to deceive . . .

The statutes succinctly set forth the elements which Plaintiff must prove. In re Harms, 53 Bankr. 134, 140 (Bankr. D. Minn. 1985). To prevail, Plaintiff must prove all of the elements by clear and convincing evidence. In re Van Horne, ____ F.2d ____, No. 86-1817, slip. op. at 4 (8th Cir. July 22, 1987) (applying 11 U.S.C. §523(a)(2)(A) and BANKR. R. 4005); In re Schwartz, 44 Bankr. 266 (D. Minn. 1984); In re Harms; In re Barnacle, 44 Bankr. 50 (Bankr. D. Minn. 1984); In re Pommerer, 10 Bankr. 935 (Bankr. D. Minn. 1981).

Plaintiff has proven several of the elements. There is no question that Debtor obtained money, via both extension and renewal of credit, by use of a written statement. The February 10, 1984 "Personal Financial Statement" is a classic "statement in writing . . . respecting the debtor's . . . financial condition." In re Eberle, 61 Bankr. 638, 646 (Bankr. D. Minn. 1985).

Plaintiff has also proven that a number of the major entries in the financial statement were materially false. A "materially false" financial statement is one "which paints a substantially untruthful picture of a financial condition by misrepresenting information of the type which would normally affect

the decision to grant credit." In re Harms, 53 Bankr. at 140, quoting In re Denenberg, 37 Bankr. 267, 271 (Bankr. D. Mass. 1983). See also In re Barnacle, 44 Bankr. at 54; In re Reder, 60 Bankr. 529, 537 (Bankr. D. Minn. 1986). At the time when the original and renewal loan transactions were finalized, Plaintiff's loan officers were appropriately required to evaluate a prospective borrower's asset ownership, both for possible recourse via liquidation in the event of default and as indicia of past financial responsibility through the orderly buildup of equity. The record is unclear as to the source of the several major liquid assets which Debtor scheduled on the financial statement as being his property. However, there seems to be no doubt that his then-wife held exclusive control over the bank accounts, and it is likely that she also held exclusive control over the Commonwealth Edison stock. It is also clear that neither Debtor nor his wife had any legally-protected fee ownership interest in their Illinois homestead. The fact that Debtor believed that he either owned or "had access to" all of these scheduled assets, and that he probably so believed in good faith, is irrevelant; in point of fact, he did not—they were not his property—and, as a result, any actual or implied assertion in the financial statement to the contrary was false. The relative magnitude of asset value entries on the financial statement was such as to normally affect a decision to make a loan of the size and character in question, so the falsity of the financial statement entries was material.

However, Plaintiff's case fails on the subjective elements of intent and reasonable reliance. Notwithstanding Debtor's prior deposition testimony that he realized that "[t]hey wanted a financial statement so I beefed it up a

little bit,"[5] there is simply no evidence that Debtor intended to induce Mueller to grant him a loan from Plaintiff on the basis of an admittedly-false financial statement with a concomitant realization that he was not or may not have been creditworthy. Rather, the record fully supports a finding that Debtor had enjoyed a respectable income in the recent past, reasonably expected to receive the rain insurance proceeds, and had always enjoyed good credit; and that, through their friendship and their pre-loan conversations, Mueller was aware of these circumstances. It is likely that Debtor did "beef up" the value of his musical instruments for the Norwest Bank Camden financial statement to some degree. This is, however, only one entry on the disputed statement. Though he did not legally have access to the various Illinois-sited assets, he reasonably believed (as a layman) that he did have access and entitlement to them. The only finding on Debtor's intent to induce that can be drawn from the record before this Court is that he intended to induce Mueller to give him the loan based upon his income and the rain insurance proceeds as sources of payment or recourse, and that he understood the financial statement to be a mere formality. To be sure, the Bankruptcy Court may make an inference of fraudulent intent once a §523(a)(2)(B) plaintiff has proved use of a materially false financial statement to obtain credit and the creditor's reasonable reliance. In re Harms, 53 Bankr. at 141. However, the inference is anything but mandatory on the facts here.[6]

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[5]See transcript of deposition in supplementary proceedings, The Highland Bank, Judgment Creditor, v. Paul R. New, Judgment Debtor, Minnesota State District Court for the Second Judicial District, Ramsey County, taken on November 14, 1985.

[6]Mueller's testimony would probably have shed more light on this issue, and may have markedly strengthened Plaintiff's case.

The element of reasonable reliance is the weakest link in Plaintiff's case and judgment in favor of Debtor would be merited on its failure to prove up reliance by clear and convincing evidence even had Plaintiff proven fraudulent intent on Debtor's part. A creditor seeking an exception from discharge under 11 U.S.C. §523(a)(2)(B) must prove that it both actually and reasonably relied upon the false financial statement. In re Harms, 53 Bankr. at 140; In re Reder, 60 Bankr. at 437; In re Eberle, 61 Bankr. at 647. It is clear that only Mueller made the determination of creditworthiness and decision to grant the loan to Debtor on behalf of Plaintiff, and that none of Plaintiff's other officers or employees participated in that decision. There is virtually no evidence that would support a conclusion that Mueller actually relied on the financial statement in his assessment of creditworthiness. To be sure, it does appear that Mueller solicited and received the financial statement from Debtor before Mueller made the loan.[7] Plaintiff argues that the Court may infer reliance from the sequence of events of receipt of a financial statement prior to a grant of credit, and a subsequent actual grant of credit, citing Industrial Bank of Commerce v. Bissel, 219 F.2d 624 (2d Cir. 1985), In re Whiting, 10 Bankr. 687 (Bankr. E.D. Pa. 1981), and In re Janes, 51 Bankr. 932 (Bankr. D. Kan. 1985). The drawing of such an inference is extremely suspect, given the mandate to narrowly construe exceptions to discharge against the creditor and liberally in favor of the debtor, In re Van Horn, ___ F.2d at ____, slip op. at 4, and the requirement that a creditor prove all of the elements of an exception to discharge by clear and convincing evidence, id. Such an inference is arguable only where a debtor fails to elicit evidence that the creditor actually relied

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[7]At trial, Debtor insisted that he did not give the financial statement to Mueller until January, 1985, when Mueller first asked for it. The record gives the lie to this assertion. On its face, the loan comment sheet

upon factors extraneous to the financial statement. Here, it is absolutely clear that Mueller was motivated by his friendship, sympathy, and personal ties to Debtor, and that he relied only upon his personal relationship with Debtor and his assessment of the prospects of satisfaction from the rain insurance proceeds, in deciding to make the loan to Debtor. Mueller's loan comments, duly reviewed by Plaintiff's then-President without challenge, clearly indicate that this was the case.[8] Mueller plainly expected a lump-sum repayment from the rain insurance proceeds. This Court can only conclude that Mueller—and by extension, Plaintiff— did not actually rely on Debtor's admittedly-false financial statement in making or renewing the loan.[9]

Plaintiff has failed to prove all of the elements of §523(a)(2)(B) by clear and convincing evidence. As a result, it cannot succeed in having its debt excepted from discharge.

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received as Plaintiff's Exhibit 5 indicates that several of Plaintiff's other officers, including Plaintiff's then-President, reviewed the loan comments and file documentation shortly after preparation of the loan comments, in accord with Plaintiff's practice. The Court has accorded more weight to this evidence than to Debtor's vague testimony on the question. The loan comments clearly indicate that a personal financial statement was on file and that a determination of Debtor's net worth was made from it. The comments were initialed by an outgoing president, who was not in Plaintiff's employ in January, 1985. The comments' reference to Debtor's net worth matches that on the financial statement. Debtor has not proven—or even argued—that the loan comment sheet was fraudulently prepared after the fact.

[8]Some evidence to support Debtor's position that Mueller was merely trying to "paper up" the loan by putting his financial statement on file is afforded by Mueller's loan comment reference to his having known Debtor for over one year—when, at the time of the loan, he had known Debtor for only a little over eight months.

[9]Were it necessary to go beyond the subsidiary element of actual reliance to that of reasonable reliance, the record also would tend to disfavor Plaintiff. At trial Plaintiff's counsel attempted to make much of the fact

ORDER FOR JUDGMENT

Based upon the foregoing Findings of Fact and Conclusions of Law, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that Debtor's debt to Plaintiff, as evidenced by a judgment entered in Minnesota State District Court for the Second Judicial District, Ramsey County, on September 27, 1985, was not excepted from the discharge in bankruptcy granted to Debtor by this Court's Order of September 3, 1986.

LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT:

GREGORY F. KISHEL
UNITED STATES BANKRUPTCY JUDGE

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that the financial statement—clearly given in its entirety to another bank six months earlier, and presented unaltered to Plaintiff—asserted a balance in an account held with "this bank." Plaintiff would argue that this should be taken as an assertion of the existence in an account at the bank to which it was being submitted. The record clearly shows that Mueller was aware of the origins of the statement, and defeats any conclusion that Mueller could blandly assert he was misled by this entry. Mueller was fully aware that the financial statement was prepared for another bank and Plaintiff's fixation at this point on this entry as evidence of utter fraud is somewhat hollow. One might even go so far as to say that this was a "red flag" that should have alerted Mueller to make further inquiry as to whether the apparent assertion in that entry was then accurate, and whether other entries were still accurate. See, In re Harms, 53 Bankr. at 144.