UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In Re: Btcy. No. 3-94-2060
Russell J. Krautkremer, Chapter 7 Case

Debtor.

Marquette Bank New Prague,

Plaintiff, ADV 3-94-142

v.

Russell J. Krautkremer, ORDER

Defendant.

This nondischargeability action was tried on January 9, 1995. Appearances were noted on the record. The Court, having received and considered all proper evidence, arguments, briefs of counsel, and being fully advised in the matter, now makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.

Plaintiff Marquette Bank New Prague is a Minnesota banking institution located in New Prague, Minnesota. Defendant Russell J. Krautkremer is a businessman and individual general investor. This litigation is based on a loan of $85,000 from Marquette to Krautkremer on July 7, 1992. The loan was to be secured by coffee equipment that Krautkremer represented he owned in connection with the transaction. The representation was made orally, in a security agreement and in a written financial statement that he gave Marquette.

Krautkremer subsequently defaulted on the loan, and Marquette learned that he did not own the equipment. None of the $85,000 debt has been collected by Marquette. The bank seeks nondischargeability of the debt under both 11 U.S.C. Section 523 (a)(2)(A) and (B), for fraud.

Krautkremer denies that his conduct resulted in any nondischargeable obligation to Marquette. In addition, he counterclaimed, seeking return of all interest payments made on the loan, alleging that Marquette improperly used him as an intermediary to actually make the loan to a company that the bank had long done business with, Regency Coffee. Krautkremer claims that Regency was in trouble on its loans with Marquette at the time, and used him to shore up the loans on the bank's books.

II.

In either late 1989 or early 1990, Krautkremer was introduced by his

accountant to Ron Burton, who was a partner in Regency Coffee. Over the course of the next few years, Krautkremer personally loaned to Burton, or borrowed on his behalf, approximately $780,000 for use by Regency.(1)

Apparently, In June 1992, Burton took over full ownership of Regency, and Krautkremer became Regency's manager. It became immediately obvious to him at that time, he claims, that Regency was in serious financial difficulty. So, he agreed with Burton that they needed to obtain more financing. Both Burton and Krautkremer went to Marquette on the afternoon of July 7, 1992, to request a loan for $85,000 to be used for Regency.

Marquette knew that Regency was not in good financial condition. The bank was its principal lender, and the loans were in default. Marquette also knew Krautkremer. He had guaranteed an obligation owing Marquette by another borrower. That account had been paid in the ordinary course.

At the July 7 meeting, the loan was made, closed, and the proceeds were disbursed within an hour. In connection with the transaction, Burton handed Krautkremer a list of coffee equipment and stated that it was Krautkremer's. Krautkremer, in turn, represented to Marquette that it was indeed his, and he used the property as collateral to secure the loan.

Ownership of the equipment had been the subject of discussion in the past between Marquette and Burton. Marquette had conducted a UCC search four months prior to July 7th, and was aware of problems with its collateral. The bank had reason to believe that ownership had been misrepresented by others connected with Regency Coffee.

However, a security agreement was signed by the parties, wherein Krautkremer repeated in writing the earlier oral representation of ownership, and the loan was closed. Marquette requested at the closing that Krautkremer furnish a bill of sale for the equipment in his name; and, that he furnish a financial statement. But the loan was closed without Marquette having received either.

Two days later, on July 9, Krautkremer provided Marquette a personal financial statement in which he also represented ownership of the coffee equipment. No bill of sale was ever furnished. Marquette filed to perfect its security interest in the coffee equipment, based on the information that it had in its file.

The loan was renewed four times,(2) based on the original security agreement. The last renewal was due on November 15, 1993. Krautkremer defaulted, and Marquette commenced an action against him in Scott County for the amount of the outstanding debt under the last renewal. The bank discovered in the process that Krautkremer did not own the equipment.

Krautkremer does not presently claim that he ever owned the coffee equipment. He testified at trial that he believed Burton on July 7, 1992, when Burton told him that he owned the property. But he also testified that he doubted the equipment was his, and that he chose not to tell Marquette about his doubts. Krautkremer claims that the first time he had heard about the equipment, was when it was mentioned at the July 7th meeting. He maintains that he had possession or control of the equipment; and, that he does not know what might have become of it.

Finally, Krautkremer argues that Marquette knew that there were possible problems concerning the ownership of the coffee equipment, based on a UCC search conducted by Marquette four months prior to July 7th.(3) He claims that Marquette had a responsibility to independently investigate the collateral, based on its original UCC search of the Regency coffee equipment.

III.

A. 11 U.S.C. Section 523(a)(2)(A) Analysis.

11 U.S.C. Section 523(a)(2)(A) provides, in pertinent part:

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

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by --

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

For a creditor to prevail under Section 523(a)(2)(A), it must prove that:

1. the debtor made a false representation of a material fact;
2. he knew it was false;
3. he made the representation with the intention and purpose of deceiving deceiving the creditor;
4. the creditor relied on the representation;
5. the creditor sustained the alleged loss and damage as the proximate result of the false representation having been made.

Thul v. Ophaug (In Re Ophaug), 827 F.2d 340 (8th Cir. 1987).

Krautkremer obtained the loan from Marquette on his representation that he owned coffee equipment, which he did not in fact own. Marquette was unable to collect on its debt by repossession, and the bank has not otherwise been repaid the loan. The critical elements in this case are Krautkremer's knowledge; his intent; and, Marquette's reliance on the representation.

1. Knowledge and Intent to deceive.

Marquette alleges that Krautkremer knowingly represented ownership of the coffee equipment with the intent to deceive the Bank. Marquette offers as evidence of this intent the fact that Krautkremer orally represented that the coffee equipment was his; and, that he signed the security agreement, which both represented that he owned it, and identified as collateral the coffee equipment detailed on specific lists. In addition, the bank argues that, by personally preparing and later submitting the financial statement in which he claimed ownership of coffee equipment valued at $112,000, Krautkremer perpetuated the fraud.

Krautkremer claims that he first heard about the equipment at the July 7th meeting. He maintains that he believed Burton when he stated at that same meeting that Krautkremer owned the equipment described in the lists. However, he also testified that he was never sure if the equipment was really his. In addition, Krautkremer acknowledged at trial that he doubted that the equipment was his, but did not tell Marquette about his doubts.

Knowledge and intent to deceive may be shown by circumstantial evidence, and may be inferred by surrounding circumstances. See Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987). When the creditor introduces circumstantial evidence tending to prove the debtor's intent to deceive, the debtor "cannot overcome [that] inference with an unsupported assertion of honest intent." In re Van Horne at 1287 citing In re Simpson, 29 Bankr. 202, 211-12 (Bankr. N.D. Iowa 1983). The focus is whether Krautkremers actions "appear so inconsistent with [his] self-serving statement of intent that the proof leads the court to disbelieve [him]." In re Van Horne at 1288 citing In re Hunt, 30 Bankr. 425, 441 (M. D. Tenn. 1983).

The evidence indicates that Krautkremer knew that he did not own the

equipment, and that he had the requisite intent to deceive the Bank in representing that he did own it. From the totality of facts and circumstances at the time of the July 7th loan meeting, there exists a strong inference that Krautkremer, an experienced businessman, knew that the coffee equipment he agree to use as collateral for the Marquette loan was not his. His representation otherwise, and his grant of a security interest in equipment he did not own, are persuasive evidence of actual fraud with intent to deceive.

2. Reliance.

Krautkremer argues that Marquette knew that there were possible problems concerning the ownership of the coffee equipment, based on a UCC search conducted by Marquette four months prior to July 7th. He claims that Marquette had a responsibility to independently investigate the collateral, based on its original UCC search of the Regency coffee equipment. Accordingly, Krautkremer argues, Marquette did not reasonably rely on any representation of his regarding ownership.

Marquette correctly points out that reliance is not measured by a "reasonableness" standard in 11 U.S.C. Section 523(a)(2)(A) proceedings. Accordingly, Krautkremer's argument does not present a relevant consideration. See: Thul v. Ophaug (In re Ophaug), 827 F.2d 340,342-343 (8th Cir. 1987).

B. Section 523(a)(2)(B) Analysis.

11 U.S.C. Section 523, Exceptions to discharge, provides, in pertinent part:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt --
>
> (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;

Marquette argues, alternatively, that the security agreement constituted a written statement about Krautkremer's financial condition, and that the elements necessary to prove nondischargeability under Section 523(a)(2)(B) were met. The security agreement, however, was not a statement of Krautkremer's financial condition within the meaning of Section 523(a)(2)(B). A Section 523(a)(2)(B) written statement generally applies to financial statements. Neither the security agreement, nor the coffee equipment list used in conjunction with the security agreement, was a financial statement.(4) Furthermore, the documents, whether standing alone or taken together, do not address Krautkremer's financial condition.

IV.

Krautkremer's Counterclaim.

Krautkremer alleges that Marquette improperly used him as an intermediary to actually make the loan to Regency Coffee. He claims that Regency was in trouble on its loans with Marquette at the time, and that the bank used him to shore up the loan on the bank's books. He seeks judgment for interest payments that he made on the note. Krautkremer neither offered any

evidence nor articulated any legal theory that would entitle him to such relief.

V.

Based on the foregoing, it is hereby ORDERED:

1. Russell J. Krautkremer's debt to Marquette Bank New Prague in the original amount of $85,000, is nondischargeable under 11 U.S.C. Section 523(a)(2)(A); and, the debt is not discharged by the 11 U.S.C. Section 727 general discharge entered in favor of Krautkremer in Bankruptcy Case No. 3-94-2060.

2. Krautkremer's counterclaim for repayment of the interest already made to Marquette is dismissed with prejudice.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: March 31, 1995.   By The Court:

____

DENNIS D. O'BRIEN
CHIEF U.S. BANKRUPTCY JUDGE

(1)
Krautkremer testified that about 60% of that amount was in bank loans signed for by him. He also testified that he never received any notes or other evidence of indebtedness from Burton or Regency; nor did he receive any documented equity interest in the company. In short, according to Krautkremer,
he received nothing tangible in return for his $780,000 participation in the business. Only a small portion of the funds that Krautkremer loaned for the business were repaid to him.

(2)
Krautkremer renewed this loan on October 7, 1992; March 2, 1993; June 18, 1993;
and September 28, 1993, under the original terms, except the due date was extended.

(3)
Krautkremer argued that the UCC search was significant in that it proved that Marquette knew there was a problem with the equipment_s ownership. Ironically,
the UCC search specifically showed that the equipment was located at Midwest AC, Jordan, MN, which was Krautkremer's own company.

(4)
Marquette does not seek relief under 11 U.S.C. Section 523(a)(2)(B) regarding financy statemnt that Krautkremer furnished the bank in the transaction. The statement that Krautkremer furnished the bank in the transaction. The statement was delivered after the loan was closed, and the bank does not claim that it later relied on the document in connection with the renewals.