In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

- Appealed 4/22/94;
- Appeal Withdrawn by Defendant 7/19/94

DONALD KARRER Debtor.	Bankruptcy No. X91-02031S Chapter 7
PAUL A. BRAUNGER Plaintiff vs. DONALD KARRER d/b/a Guidos d/b/a Normandy Hunt Club Defendant.	Adversary No. X92-0047S

ORDER RE: DISCHARGEABILITY OF DEBT

Paul A. Braunger (BRAUNGER) seeks determinations that Donald B. Karrer is indebted to him and that the debt not be discharged because of Karrer's fraud. This is a core proceeding under 11 U.S.C. § 523(a)(2)(A). Trial was held on April 14, 1993, in Sioux City. James W. Redmond and Patrick H. Tott appeared for Braunger. Donald H. Molstad appeared for Karrer.

I.

Findings of Fact

Donald Karrer, the debtor, was in the restaurant business in Sioux City for 26 years. In 1991, he was involved, through various business forms, in the operation of two restaurants, a deli/bakery, and several Dairy Queens. The restaurants, Guidos and The Normandy Hunt Club, were owned and operated by Herkar, Inc., an Iowa corporation. Karrer and Ted Herbold owned the stock of Herkar in equal shares. Karrer and Herbold, as partners, owned the Pioneer Deli and Bakery in Sergeant Bluff, Iowa. Karrer was involved in various ways in the ownership and operation of Dairy Queen stores in the Sioux City area. The evidence was inexact on the nature of his interests. It appears that he and a man named K. Wayne Johnson owned a corporation named W.J./D.K., Ltd., a holding company which had granted franchise rights to nearly all the Dairy Queen stores in the area. Karrer Enterprises, Inc., the stock of which was owned equally by Donald Karrer and his wife Judy, was a franchisee which owned Dairy Queen stores in Sioux City. Karrer testified that he and K. Wayne Johnson owned

two franchise stores together, but it is unclear in what business form they were owned. In the spring of 1990, Karrer Enterprises, Inc. sold one of its Dairy Queen stores, by installment contract, to Clifford and Robin Tague. The contract called Tagues to make for a $25,000.00 downpayment in May, 1990, and to make monthly payments thereafter. A balloon payment was due in 1997.

Karrer and K. Wayne Johnson had entered into a buy-out agreement which would give either of them a limited-in-time option to buy the other's shares of stock in W.J./D.K., Ltd. at the time of the other's death. The agreement, in Karrer's opinion, set the buy-out price below the stock's true value. When K. Wayne Johnson died in 1990, Karrer was eager to take advantage of the buy-out agreement and to purchase Johnson's shares from his estate. Karrer had already investigated selling the stock, and he believed that upon purchase of Johnson's shares, he would make a substantial profit by selling the Dairy Queen franchises, personalty and realty.

He was pressured, however, by the limited amount of time he had to exercise the buy-out and because he was having difficulty in coming up with all of the funds needed to exercise the option. Karrer needed approximately $34,000.00 more than he had. He approached Norwest Bank, N.A. in Sioux City, but it declined to make the loan.

Karrer had done business with Paul Braunger for 20 years. Braunger was in the wholesale food business. He operated either as a sole proprietor or corporately as Braunger Institutional Foods, Inc., but which, if not both, is unclear. His primary business was to sell processed meat, frozen foods, produce and canned goods to schools, hospitals and restaurants. Braunger sold provisions to all the food businesses with which Karrer was involved.

Sometime in the spring of 1990, Karrer approached Braunger and asked his help in obtaining the loan from Norwest so that he could complete the buy-out from the Johnson estate. Karrer asked Braunger to attend a meeting with the bank; he wanted Braunger to speak on his behalf. Braunger, who banked at Norwest, believed he was being asked to the meeting to act as a "character reference" for Karrer. Karrer and Braunger met with the bankers about the first week of June, 1990. One of the bankers bluntly told Braunger that Karrer needed $34,000.00 and that the bank would not lend it unless Braunger also became obligated to repay the loan. Braunger was taken aback. At the time Karrer's various operating entities owed Braunger about $30,000.00. Now he was being asked to risk $34,000.00 more. Braunger and Karrer stepped outside the meeting room and visited privately.

Karrer explained to Braunger that he needed the money from Norwest only for a short time. Karrer had recently sold a Dairy Queen in the Leeds area of the City, one that he personally owned, and by July he would have funds necessary to pay off the $34,000.00 from Norwest. Karrer offered Braunger security, an assignment of the Karrer Enterprises/Tague contract on another store. Karrer estimated that the value of the collateral--either the contract or Karrer's seller's purchase money security interest in the property sold--was worth at least $90,000.00. He tried to convince Braunger that there was no risk in helping him to get the Norwest loan.

Braunger told Karrer he did not feel right "signing a note" when Karrer was already "into him for $30,000.00." According to Braunger, Karrer responded: "I never stuck you. I don't intend to ever stick you. I'll tell you what, when this thing comes through, it's going to be worth three or four hundred thousand. I can buy it for $100,000.00. All I need is $30,000.00 today and I can swing the deal and I can have the franchise."

According to Braunger, Karrer also said, "Paul, sign this thing, I'm going to get this Dairy Queen franchise, and believe me that's going to make me well. I'm going to be able to pay all my

indebtedness--I'll pay you right off when we get this all done." Karrer testified that he meant he would pay off his personal indebtedness to Braunger, the account balances due on personally owned Dairy Queens, but that he did not mean debt of Guidos, The Normandy or the Deli. The court does not find Karrer's testimonial distinction credible. The court finds that he meant all debt, including the debt owed Braunger by the corporate entities.

In his mind, Braunger believed that the assignment of collateral would secure not only indemnification on the Norwest guaranty, but also all existing debt owed to Braunger by Karrer's restaurants and Dairy Queens, regardless of how owned. Braunger felt that even if he became liable for the Norwest guaranty, he was better off because he was getting security for the other debts, so Braunger agreed to guarantee the loan.

A week later, on June 14, 1990, Donald and Judy Karrer went to Norwest to obtain the loan. They were to meet Braunger there, but he was late. Braunger called the bank, talked to Karrer and asked to meet him at a fast food restaurant located on the first floor of the building where the bank was located. Braunger and the Karrers met there briefly. Braunger said he did not know why he was agreeing to the guaranty. Karrer again assured him he could not get hurt on it. They went upstairs and met again with the bankers to execute the loan documents. Braunger signed the guaranty (exhibit 1) and left. He had formally agreed to guaranty Norwest's $34,000.00 loan to the Karrers.

When he went back to work that day, he told Leonard Morgan, his credit manager, "We just got everything secured. We're in the driver's seat. I got $86,000.00 worth of property signed over to us today, and I signed a note for another $30,000.00."

The same day, Karrer personally and for Karrer Enterprises, executed the assignment to Braunger. On June 19, 1990, Stewart A. Huff, Karrer's attorney, forwarded the Karrer Enterprises-Tague installment purchase agreement and its assignment to Braunger to the Woodbury County Recorder for recording. The assignment stated that it was given in consideration of Braunger's guaranteeing Norwest's loan of $34,000.00 to Karrers. By it, Karrer Enterprises, Inc. assigned to Braunger and/or Braunger Institutional Foods, Inc. all of the company's rights to the Tague contract and its related documents. The assignment was stated to be "FOR COLLATERAL ON SUCH GUARANTEE ONLY. . . ." (Exhibits B and 3). If Karrer Enterprises or the Karrers personally defaulted on the Norwest loan, then, on written notice to them, the assignment would become absolute. There was nothing in the assignment which indicated it represented security for any other claim by Braunger against Karrer Enterprises, Donald Karrer, or any entity owed by Karrer.

After it was recorded, Huff sent a copy of the Tague contract and the assignment to James Redmond, Braunger's attorney. On July 11, Huff sent a copy of the recorded assignment, without attachments, to Braunger. Braunger had been told at the loan closing what the assignment was about. From his testimony, it is doubtful he read it at that time. He testified that the first day he may have seen it was the day he released it. He knew a copy of it was filed at his office. Leonard Morgan, Braunger's credit manager, did not read the assignment or "get involved with it."

Before the assignment was executed, because of the growing debt of Karrer's enterprises to Braunger, all of the businesses had been put on a C.O.D. basis and before the assignment was executed, Braunger had been considering suing Karrer. Because he believed he was now secure, Braunger dropped the idea of suing Karrer and ended the C.O.D. restriction. Braunger reinstituted his normal billing practice which was to deliver provisions during one week and collect for those deliveries by Friday of the following week. The Karrer businesses again began falling behind on their weekly payments to Braunger.

When Karrer closed on the sale of the Leeds Dairy Queen in mid-July, he repaid the $34,000.00 loan to Norwest. After paying off the bank, an excited and happy Karrer purchased an expensive bottle of champagne and gave it to Braunger as a thank-you gift.

Following some conversations with Karrer, Huff wrote to Karrer on July 25, 1990, saying that if Karrer had made arrangements "to pay off Paul Braunger," they needed to get the assignment released. (Exhibit E). Both Karrer and Huff began calling Braunger to get him to release the assignment. Huff wrote Braunger on August 1, 1990, sending him release forms and asking for their return. Braunger told Huff he would not release until he got all his money. Braunger, on at least one occasion, avoided talking to Karrer when he came to Braunger's office to get the release signed. Since he could not talk to Braunger, Karrer met with Leonard Morgan and Mark Boe, Braunger's general manager. According to Boe and Morgan, Karrer assured them that upon the sale of Karrer's Dairy Queen interest, Braunger would get paid all of his money. Karrer admits having the conversation but again says that he made clear that he was talking about his personal debts to Braunger on the Dairy Queen accounts.

In the spring of 1991, Karrer's need for the release of the assignment was becoming more pressing. He had sold personally, and corporately, all of the Dairy Queen properties, including franchise rights, realty and personalty, to the widow of K. Wayne Johnson. The closing date on the sale was approaching. Included in the sale was Karrer Enterprises' rights in the Tague contract. Huff felt that Karrer's failure to get Braunger's release of the assignment would impede, if not prevent, the closing.

Braunger claims that in conversations with Karrer prior to the closing, Karrer promised that when the deal closed, Braunger would get all of his money. According to Braunger, Karrer said, "I've never beat you out of a dime. I've promised you all along, I'm going to pay you every dime I owe you. This thing is going to get settled. I'm going to get good money out of this thing." Braunger said Karrer promised to pay him the day the Dairy Queen sale closed. Karrer admits that he told Braunger that he would be paid all of the money owed to him, even if Karrer had to take it out of his personal share of the sale's proceeds.

Braunger signed the release on May 15, 1991, he says, based on Karrer's promise of full payment. The closing of the Dairy Queen sale took place on or about June 17, 1991. According to the closing statement, the gross purchase price for the assets was $648,837.05. Credits against the price included sellers' loan repayments, repayment of a debt to K. Wayne Johnson's estate, and the buyer's down payment. The sellers, W.J./D.K., Ltd. and Karrer Enterprises, Inc., were to receive $340,813.29 from the buyer at closing. Huff already held the down payment of $34,125.00. Thus, as a result of the sale, there was $374,938.29 in Huff's trust account for distribution. Various obligations were paid from this amount. These obligations included a payment in the amount of $6,653.88 for Dairy Queen debts to Braunger and a $74,080.30 payment to First Interstate Bank. The latter payment was for two debts not owed to First Interstate by the sellers. Herkar owed the bank approximately $33,000.00, and Donald Karrer owed the bank $40,000.00 for money borrowed by him to keep the Normandy restaurant going. The $40,000.00 was secured by Karrer's house. To secure the debt, Judy Karrer had signed the mortgage, but she had not signed the note. First Interstate Bank sent a representative to the closing to collect these two loans in full. Karrer says he was surprised that the bank demanded payment of the $33,000.00 loan at that time. He was not surprised by the demand that the short term $40,000.00 loan be repaid.

Donald and Judy Karrer received approximately $189,142.24 in cash at the closing. There is no evidence as to how this money was transferred to them personally from the selling corporations. Donald Karrer contends that half of the closing money belonged to his wife because of her ownership

interests. Because of the lack of evidence, it is unclear to the court whether this is so. There was not sufficient evidence to show which entities or persons owned which of the items of property that were sold. It is doubtful that the sale proceeds boiled down to a 50-50 split between Karrer and his spouse. Nonetheless, the couple at some point treated the proceeds as half owned by each. However, the couple maintains that since Judy was not liable to First Interstate Bank, an accurate calculation of her ownership in the net proceeds of sale would be made by adding $189,142.24 and $74,080.30 and dividing by two and then by subtracting $74,080.30 from Donald's share. This would result in a division of the seller's cash at closing of $131,611.27 for Judy and $57,530.97 for Donald.

When Braunger received his check of roughly $6,600.00 for the Dairy Queen debt, he was very upset. Leonard Morgan called Karrer about not being paid in full for all debts to Braunger. Karrer told Morgan he had some trouble with the bank at closing and that they were working on it. Karrer told him he would get it taken care of.

Braunger also called Karrer. He wanted to know where the rest of the money was. Karrer told Braunger that the bank had showed up at the closing and demanded its loans be paid off. He said Huff was going to get it straightened out. He told Braunger to "sit tight," that he would get it taken care of in a week or so.

Braunger called Karrer a couple weeks later. Karrer told him that Huff had not yet resolved the matter with the bank. Karrer also told Braunger that the Normandy was not doing well and that he did not have a lot of money left from the closing. Karrer explained that half of the money belonged to his wife.

Braunger kept contacting Karrer about payment. At the last, Karrer told Braunger that the money from the closing was gone. About that time, the Normandy closed. Braunger thinks the last conversation took place in November, 1991. Karrer filed personal bankruptcy on November 8, 1991.

In September, 1991, Judy Karrer opened an account in her name only at Firstar Bank in Sioux City. Her opening deposit was between $80,000.00 and $85,000.00.

After the closing, but before bankruptcy, Karrer paid off a $10,000.00 balance on a loan used to build a swimming pool at his home the year before. Judy Karrer bought a car; Donald Karrer bought a used Cadillac in his and Judy's names but for his use. Prior to filing bankruptcy, the couple went on a one-week driving vacation. Karrer paid off a $34,000.00 loan he had taken out for which his mother's home was mortgaged as collateral. It is unclear when this debt was paid. Karrer also used sale proceeds to pay business-related taxes and to keep the restaurants operating.

Karrer paid nothing to Braunger to take care of the delinquent debts from the Normandy, Guidos or the Pioneer Deli/ Bakery. Karrer said he never promised to pay those debts out of the closing proceeds. He said he had told Braunger only that he would not let him get stuck on those debts, even if he had to take it out of his proceeds. His wife, he said, refused to let any of her money be used. She had given him substantial funds, he said, to keep the Normandy going. But finally, Karrer claimed, she said, "No more." Karrer said he ran out of his money trying to keep the Normandy in operation. When his business partner, Ted Herbold, refused to inject any more operating capital into Herkar, Karrer made the decision to close the Normandy and to file personal bankruptcy.

At the time of filing, all of Karrer's personal obligations to Braunger arising out of Dairy Queen purchases had been paid. There were 15 unpaid invoices from the Normandy to Braungers arising

from purchases dating from October 3, 1989 through November 22, 1989. All arose before the existence of the guaranty or the assignment. They total $6,041.84.

There are two unpaid invoices which were for sales to the Normandy on August 15, 1990. These total $2,365.88. The Normandy failed to pay for purchases made March 21, 1991, in the amount of $1,192.12; for purchases made March 26, 1991, in the amount of $431.64; and for purchases made May 3, 1991, in the amount of $971.95.

Six checks given by Herkar, Inc. for purchases for the Normandy were returned dishonored: (1) check no. 2316 dated November 23, 1990, in the amount of $3,011.67; (2) check no. 2815 dated February 15, 1991, in the amount of $2,879.25; (3) check no. 3035 dated April 12, 1991, in the amount of $2,151.24; (4) check no. 3199 dated May 31, 1991, in the amount of $1,697.58; (5) check no. 3233 dated June 14, 1991, in the amount of $500.00; and (6) check no. 3234 dated June 14, 1991, in the amount of $500.00.

With regard to the dishonored checks, the court cannot determine the dates of the purchases for which they were used to pay. It may be that they are bad checks used to pay old debt, although it is more likely they were used to pay for purchases made near in time to the date of the check. But in view of testimony that the Normandy regularly fell behind in its payments, it cannot be found that each check was given for purchases made within the preceding week.

At the time Karrer filed his chapter 7 case, Braunger was owed $30,224.50. This figure comprises $21,743.27 in unpaid purchases by the Normandy; $1,798.88 in unpaid purchases by Guidos; and $6,682.35 in unpaid purchases by the Pioneer Deli/Bakery. Braunger also claims interest on all accounts totaling $2,969.85.

II.

Bankruptcy Code § 523(a)(2)(A) provides that a chapter 7 discharge does not discharge a debt:

> 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.

11 U.S.C. § 523(a)(2)(A). To hold a debt nondischargeable, a plaintiff must prove that the debt falls within an exception to discharge by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 657-58 (1991).

False pretenses or false representations involve a false statement of present or past fact. Webster City Production Credit Ass'n v. Simpson (In re Simpson), 29 B.R. 202, 208-09 (Bankr. N.D. Iowa 1983). To prove actual fraud, a creditor must show:

1. That the debtor made the representations;
2. That at the time made, the debtor knew the representations to be false;
3. That the representations were made with the intention and purpose of deceiving the creditor;
4. That the creditor relied on such representations; and
5. That the creditor sustained the alleged loss and damage as the proximate result of the representations having been made.

Id., 29 B.R. at 209; Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 342, n.1 (8th Cir. 1987). A promise to perform a future act is an actionable representation only when made with existing real intention not to perform. Grefe v. Ross, 231 N.W.2d 863, 867 (Iowa 1975); Hagarty v. Dysart-Geneseo Comm. School District, 282 N.W.2d 92, 95 (Iowa 1979).

To find debt nondischargeable under § 523(a)(2)(A), a creditor need not prove that reliance on the debtor's fraudulent misrepresentation was reasonable. Ophaug, 827 F.2d at 343. However, "reasonableness is circumstantial evidence of actual reliance; that is, dischargeability shall not be denied where a creditor's claimed 'reliance' . . . would be so unreasonable as not to be actual reliance at all." Northern Trust Co. v. Garman (In re Garman), 643 F.2d 1252, 1256 (7th Cir. 1980), cert. denied 450 U.S. 910 (1981).

III.

Braunger makes two arguments that he is entitled to a non-dischargeable judgment against Karrer. First, he contends that Karrer fraudulently induced him to release the assignment by misrepresenting his intention to pay Braunger out of the proceeds of the Dairy Queen closing. Second, Braunger asserts that Karrer, by the same misrepresentation, obtained extensions of time in which to pay his debts to Braunger. The court concludes that the former theory has no merit, but that on the latter, Karrer's debt to Braunger should be nondischargeable.

Braunger's theory that his release of the assignment was fraudulently obtained is without merit because Braunger gave up nothing to which he was entitled in releasing the assignment. Nothing in the Assignment stated that it secured anything other than the Guaranty. There is no credible evidence that Karrer made any representation that it did. When Karrer paid off the bank loan, Braunger was no longer contingently liable on the Guaranty, and Karrers and Karrer Enterprises were entitled to its release. At the time of the release, any new promise made by Karrer that he would pay Braunger out of the Dairy Queen proceeds would be, by itself, unenforceable as being without consideration.

But Karrer had already made that promise. He had made it at the time Braunger agreed to guarantee Karrers' note to Norwest. A week before the signing, Karrer induced Braunger to guarantee the note by promising him that he would pay all the debts. The court does not find credible Karrer's testimony that he meant only the debts represented by the Dairy Queen accounts. Karrer's personal promise to pay the accounts which his various business entities owed to Braunger was supported by new consideration--Braunger's guaranty--and therefore proof of it is not prevented by the statute of frauds. Iowa Code § 622.32(2), Maresh Sheet Metal Works v. N.R.G., Ltd., 304 N.W.2d 436, 439 (Iowa 1981).

Not only had Karrer promised to pay the debts owed to Braunger by the various entities, but he promised to do so when the sale of his Dairy Queen interests closed. This took place in June 1991. As part of the transaction, Braunger was paid in full on the accounts owed by the Dairy Queens; this was part of the bulk sale transaction. But when he did not receive payment on the other accounts, Morgan, Braunger's credit manager, complained. Despite the fact that Karrer had personally received at least nearly $60,000.00 from the closing, he gave as an excuse that a bank had caused some trouble at the closing. He said, however, that he would get it taken care of. Karrer, at about the same time, gave Braunger the same excuse, and told Braunger that he would get it taken care of in a week or so. Approximately a couple weeks later, Karrer told Braunger that his lawyer still had not resolved the matter. All the while these excuses were being made, Karrer was spending his share of the sales proceeds on a car, a vacation, his debt on a pool at his home, on a debt of his for which his mother had mortgaged her home, and his businesses.

Such conduct is evidence that although he was continuing to promise Braunger full payment, he did not intend to pay Braunger out of the proceeds. His representations to Braunger regarding payment were material, and they were knowingly false, at least as early as the date of closing in mid-June 1991.

Braunger relied on Karrer's promise of payment in full. He "sat tight," forgoing any effort to collect the now-personal obligation by legal means. By the time Karrer told him he could not pay him, Karrer's share of the closing proceeds had been spent; Braunger had lost his opportunity to obtain judgment and levy. From the evidence, the court infers that Karrer intended to deceive Braunger to obtain his inaction.

It remains only for the court to determine whether Karrer obtained anything by fraud. The Code requires that for the court to deny discharge of the debt, the debtor must have obtained "money, property, services, or an extension, renewal, or refinancing of credit." 11 U.S.C. § 523(a)(2)(A). There is disagreement over whether forbearance fits within any of the foregoing categories. I conclude that forbearance in collection can constitute a renewal of credit. F.D.I.C. v. Cerar (In re Cerar), 84 B.R. 524, 529 (Bankr. C.D. Ill. 1988) aff'd 97 B.R. 447 (C.D. Ill. 1989); Nisswa State Bank v. Eberle (In re Eberle), 61 B.R. 638, 645 (Bankr. D. Minn. 1985); Takeuchi Mfg. (U.S.), Ltd. v. Fields (In re Fields), 44 B.R. 322, 329 (Bankr. S.D. Fla. 1984); First Bank (N.A.) v. Eaton (In re Eaton), 41 B.R. 800, 802 (Bankr. E.D. Wis. 1984). Contra, Drinker Biddle & Reath v. Bacher (In re Bacher), 47 B.R. 825, 829 (Bankr. E.D. Pa. 1985); Ballard v. Grubbs (In re Grubbs), 9 B.R. 499, 501 (M.D. Ga. 1981). Braunger was entitled to immediate payment, but he agreed to await the outcome of future events--he first agreed to wait until the closing and then tacitly agreed to wait until Karrer resolved his problem with the bank. His forbearance amounted to a renewal of credit. The decision in Detling v. Detling (In re Detling), 28 B.R. 469, 474 (Bankr. N.D. Iowa 1983), is not to the contrary. There, the court concluded that a spouse's agreement to enter into a particular property settlement, although perhaps induced by a false financial affidavit, was not an extension or renewal of credit, even though she may have forgone an equitable remedy. Id. at 474.

At the time Karrer fraudulently caused Braunger to delay collection (June 1991), Karrer owed Braunger $21,743.27 for sales to the Normandy Hunt Club. It is reasonable to infer that by November 1991, when Karrer told Braunger he could not pay the accounts, he owed Braunger $1,798.88 for sales to Guidos and $6,682.35 for a total of $30,224.50. Braunger is entitled to recover this sum. The proof of interest was insufficient to permit calculation by the court.

ORDER

IT IS ORDERED that Paul A. Braunger shall recover from Donald Karrer the sum of $30,224.50. This debt is non-dischargeable under 11 U.S.C. § 523(a)(2)(A). Costs are taxed to the defendant. Judgment shall enter accordingly.

SO ORDERED ON THIS 6th DAY OF APRIL, 1994.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order and a judgment by U. S. mail to: Donald H. Molstad, James Redmond and U. S. Trustee