In the United States Bankruptcy Court

for the Northern District of Iowa

SEAN PATRICK FRANCKE *Debtor(s).*	Bankruptcy No. 97-00759-C Chapter 7
FARMERS STATE BANK *Plaintiff(s)* vs. SEAN PATRICK FRANCKE *Defendant(s)*	Adversary No. 97-9093-C

ORDER

On January 27, 1998, the above-captioned matter came on for hearing pursuant to assignment. Plaintiff Farmers State Bank appeared by Attorney Joseph Schmall. Debtor/Defendant Sean Francke did not appear at the time of trial, however, he was represented by Attorney Michael Mollman who participated in the trial. Evidence was presented after which the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I).

STATEMENT OF THE CASE

This adversary proceeding was filed May 29, 1997. Plaintiff asserts that Defendant made false representations to Plaintiff concerning the amount of his debt which induced Plaintiff to loan money to Defendant. Plaintiff asserts that the representations made by Defendant were false and were made with the intent to deceive Plaintiff into granting Defendant's loan application. Plaintiff seeks a determination that the debt owed to it by Defendant be excepted from discharge pursuant to 11 U.S.C. §523(a)(2)(B).

FINDINGS OF FACT

Defendant Sean Francke filled out a loan application with Farmers State Bank on January 27, 1997 (Exhibit 1). In this application, Defendant sought to borrow $7,324.58 from Farmers State Bank. Defendant offered two motor vehicles which he owned as collateral; a 1981 GMC Suburban and a 1983 Cadillac Eldorado. Defendant's father, Harold Francke, eventually co-signed this application. However, after review, the Bank declined to make the loan, concluding that the value of the collateral was insufficient to support the loan.

Defendant later called the Bank and sought approval of a loan in a lesser amount. Defendant filled out a new loan application (Exhibit 3) signed by him on February 3, 1997. Defendant sought a loan in the amount of $4,300 and offered the same collateral as previously; the two vehicles. Defendant's father

did not co-sign this application. The Bank reevaluated this application and approved a loan in the amount of $4,300.

In the second application, approved by the Bank, Defendant stated that he had income of $2,167 per month. He stated to Consumer Loan Officer Annette Marie Weih of Farmers State Bank that the purpose of the loan was to consolidate credit cards. This information was included in the loan application. In the application, Defendant listed five obligations. These were to City Bank in the amount of $754, Beneficial National Bank in the amount of $1,666, First Union in the amount of $788, Discover Card in the amount of $3,172, and GECAF in the amount of $944.

The initial loan was denied because Defendant's debt-to-income ratio exceeded 38% which is the limit upon which this bank will make a loan. Upon reapplication, Defendant sought a lesser amount and after evaluation of the debt-to-income ratio, the loan minimally qualified. The Bank, therefore, approved the loan.

Ms. Weih testified that the Bank would not have approved the loan if they had known of additional debts not reflected in the loan application. The Bank did not become aware of these debts until Defendant filed his Chapter 7 Bankruptcy Petition on March 20, 1997 and they were listed in the Schedules. The Bank asserts that the obligations of most concern were to Fingerhut in the amount of $1,700, Mt. Mercy College in the amount of $3,000, and Homeland Bank in the amount of $12,000.

Ms. Weih testified that the stated purpose for the loan was to consolidate credit cards and pay off or pay down credit card obligations. It was subsequently determined that, at the same time Defendant was making the application for the loan, he was shopping for a motor vehicle. Various lending institutions had been approached for approval of a loan to buy a vehicle. The money from Plaintiff was made available to Defendant on February 3, 1997. It appears that a substantial portion of the borrowed funds were used to purchase an F-150 Ford pickup on February 5, 1997. The remainder of the amount due on the pickup apparently was borrowed from Homeland Bank.

Therefore, Homeland Bank was not a pre-existing debt which should have been listed on the loan application. However, it does establish that Defendant misrepresented to the Bank the purpose for the loan. Defendant's stated purpose was to liquidate credit cards and it appears from the Schedules that the amounts listed on the loan application remain very similar in amounts which were eventually listed on Defendant's Schedules. This strongly implies that Defendant did not pay off or pay down these credit cards as represented to the Bank. Rather, it suggests that Defendant purchased another vehicle which was primarily financed through Homeland Bank.

Defendant had substantial obligations to Mt. Mercy and Fingerhut which were not listed on the loan application. Because of Defendant's marginal debt-to-income ratio, Ms. Weih testified that the loan would not have been made if these additional obligations had been listed.

The evidence establishes that Defendant made no payment from the time that the loan was approved until the filing of his bankruptcy petition 45 days after approval of the loan.

CONCLUSIONS OF LAW

Plaintiff bears the burden to prove the elements of its claim under 11 U.S.C. §523 by a preponderance of the evidence. See Grogan v. Garner, 498 U.S. 279 (1991). Exceptions to discharge must be "narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh

start policy of the Code. These considerations, however, 'are applicable only to honest debtors.'" In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987) (citations omitted).

Plaintiff relies on the following provisions of 11 U.S.C. §523 to support its dischargeability complaint:

> 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 --
>
> . . .
>
> B. use of a statement in writing--
>
> i. that is materially false;
> ii. respecting the debtor's or 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[.]

This Court considers a four-element test when considering whether a debt will be excepted from discharge under §523(a)(2)(B). The elements are: (1) the false financial statement is a writing respecting the debtors financial condition; (2) the financial statement is materially false; (3) the debtor intended to deceive; and (4) the creditor relied on the statement. In re Mutschler, 45 B.R. 482, 490 (Bankr. D.N.D. 1984); In re Hennings, No. 92-11755LC, Adv. No. 92-1269LC, slip op. at 7 (Bankr. N.D. Iowa Dec. 22, 1993).

The fighting issue here is whether Debtor gave false information on his financial statement with the intent to deceive Plaintiff (§ 523(a)(2)(B)(iv)). This Court has stated that "intent can be gleaned from surrounding circumstances." In re Walderbach, No. L92-00780C, Adv. No. 92-1135LC, slip op. at 8 (Bankr. N.D. Iowa Aug. 31, 1993); cf. Van Horne, 823 F.2d at 1287 (concluding that intent in a § 523 (a)(2)(A) action can be inferred from the surrounding circumstances).

FINANCIAL STATEMENT AS A WRITING

It is uncontested that Defendant submitted a financial statement to Farmers State Bank in the form of a loan application. This loan application was in writing which satisfies the requirements of §523(a)(2)(B). Defendant does not seriously contend that the loan application does not satisfy the first element and the Court concludes that the loan application satisfies the financial statement in writing the requirements of §523(a)(2)(B) as a statement in writing. In re Shelton, 42 B.R. 547, 548 (Bankr. E.D. Mo. 1984).

MATERIALLY FALSE

A materially false 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 Walderbach, No. L92-00780C, Adv. No. 92-1135LC, slip op. at 8 (Bankr. N.D. Iowa Aug. 31, 1993) (citing In re Mutschler, 45 B.R. at 490. The evidence establishes that Defendant did not list two obligations which he owed at the time of the making of the application; the debt to Fingerhut in the amount of $1,700 and Mt. Mercy College in the amount of $3,000. Debtor also misrepresented the purpose of the loan. A financial statement is materially false "if it not only contains erroneous information, but rather contains information that is substantially inaccurate." In re Dammen, 167 B.R. 545, 550 (Bankr. D.N.D. 1994). Other courts have considered a statement materially false if "the statement is grossly reckless as to its truth". In re Howard, 73 B.R. 694, 702 (Bankr. N.D. Ind. 1987) (citing In re Bogstad, 779 F.2d 370, 372 (7th Cir. 1985)); In re Martin, 761 F.2d 1163, 1167 (6th Cir. 1985).

A statement is material if it "is substantially inaccurate and [contains or lacks] information that affects the [Plaintiff's] decision-making process." Howard, 73 B.R. at 703; In re Green, 96 B.R. 279, 283 (B.A.P. 9th Cir. 1989) "Material falsity in a financial statement can be premised upon the inclusion of false information or upon the omission of information about a debtor's financial condition." Green, 96 B.R. at 283 (citing In re Anzman, 73 B.R. 156, 163 (Bankr. D. Co. 1986)).

Based upon the entire evidentiary record, it is the conclusion of this Court that Plaintiff has established by a preponderance of evidence that the loan application submitted by Defendant was materially false. While compared to some cases, the amounts listed may seem insubstantial it is clear from the record that Defendant intentionally did not include these amounts in order to qualify for this loan. The failure to list these amounts was material because it affected the Bank's decision-making process. Because of the narrow margin of debt-to-income ratio, these amounts tipped the scales in favor of granting the loan. If Defendant had disclosed these debts, Ms. Weih testified that the loan application would not have been approved.

In this context, Defendant's failure to list these obligations on the loan application does not simply constitute an inaccurate misrepresentation of his financial condition, but rather establishes that he intentionally skewed his entire financial picture to the extent that it created a substantially untruthful picture regarding his overall financial condition. Additionally, Defendant represented that he intended to use the loan proceeds to pay down certain credit card obligations. In fact, this also constituted a materially false statement as Defendant used a large portion of the proceeds to help purchase a vehicle. Instead of improving his financial picture, Defendant actually added a new obligation. This Court must conclude that the financial statement presented to the Bank was materially false.

INTENT TO DECEIVE

Plaintiff must establish that Defendant intended to deceive the Bank through Defendant's conduct. "Discharge is barred under §523(a)(2)(B) only if, among other things, the debtor acted with the intent to deceive." In re Jones, 31 F.3d 659, 661 (8th Cir. 1994). This Court has stated that "intent can be gleaned from surrounding circumstances." In re Capps, No. 93-20229KD, Adv. 93-2106KD, slip op. at 3 (Bankr. N.D. Iowa Nov. 24, 1993); Walderbach, slip op. at 8. Some factors persuasive on the issue of intent to deceive include "whether the debtor was intelligent and experienced in financial matters, and whether there was a clear pattern of purposeful conduct." Capps, slip at 5; Walderbach, slip at 8-9; see also In re Joyner, 132 B.R. 436, 442 (Bankr. D. Kan. 1991) (considering the omission of significant liabilities and financial statement as strong evidence of intent to deceive). The use of

incorrect or deceptive information on an application for the purposes of improving the chances of approval of the application establishes intent to deceive. Walderbach, slip op at 9.

In this case, the conduct of Defendant leaves little doubt of his intent to deceive the Bank. This is established not only by the failure to list the two specific obligations which would have precluded him from obtaining loan approval, but also from the other facts and circumstances of this case. Defendant represented to the Bank that he intended to use the proceeds of the loan to pay off credit card debts. However, this was clearly not done and was not his intention at the time of the approval of the loan. Rather, the record more than abundantly establishes that during this entire period of time, Defendant was shopping for a motor vehicle.

Defendant needed a down payment for this vehicle and misrepresented to the Bank the purpose of the loan in order to obtain loan approval so that he would have the cash to make a down payment on a Ford pickup. The record establishes that almost immediately upon approval of the loan, a substantial amount of the loan proceeds were used to make that down payment. Additionally, it can be concluded from this record that Defendant was aware that his debt-to-income ratio was marginal because his first loan application had been denied on that basis. Defendant was certainly aware that if he listed all of the obligations which he owed, his debt-to-income ratio would continue to exceed the 38% required by the Bank and the loan would again be denied. Based upon these conclusions, this Court finds that Plaintiff has established the third element of §523(a)(2)(B) by a preponderance of the evidence.

RELIANCE

Plaintiff must finally establish that it "reasonably relied" on Defendant's financial statement. In re Ophaug, 827 F.2d 340, 343 (8th Cir. 1987). A two-part test is used to determine whether a creditor reasonably relied on the debtor's false financial statement. The creditor must establish that: (1) the creditor actually did rely on the financial statement; and (2) the reliance was reasonable. See In re Hennings, slip op. at 8 (citing In re Myers, 124 B.R. 735, 742 (Bankr. S.D. Ohio 1991)).

The unrebutted evidence establishes that Defendant's debt-to-income ratio was always marginal. Here, more than in most cases, Plaintiff had closely examined Defendant's financial statement because of the marginal nature of the loan. Ms. Wieh testified that she relied upon that financial statement in approving this loan. The Eighth Circuit holds that "the reasonableness of a plaintiff's reliance should be judged in light of the totality of the circumstances." Jones, 31 F.3d at 662. In weighing the entire record presented to the Court, it is the conclusion of this Court that Plaintiff did rely on the financial statement of Defendant in approving this loan and that the reliance of the Bank in doing so was reasonable under all of the circumstances.

Therefore, the Court finds that Plaintiff has established reliance by a preponderance of evidence.

SUMMARY

This Court must conclude that Plaintiff has established by a preponderance of evidence each and every element required to be proven under 11 U.S.C. §523(a)(2)(B). Accordingly, Plaintiff's complaint requesting that Defendant's debt be excepted from discharge under §523(a)(2)(B) must be granted.

WHEREFORE, for all the reasons set forth herein, Plaintiff's complaint to determine dischargeability of debt under 11 U.S.C. §523(a)(2)(B) is GRANTED.

SO ORDERED this 17th day of February, 1998.

Paul J. Kilburg
U.S. Bankruptcy Judge