In the United States Bankruptcy Court

for the Northern District of Iowa

DALE P. LANGRECK *Debtor(s).*	Bankruptcy No. 97-02444-W Chapter 7
AVCO FINANCIAL SERVICES *Plaintiff(s)* vs. DALE P. LANGRECK *Defendant(s)*	Adversary No. 97-9229-W

RULING

On August 20, 1998, the above-captioned matter came on for hearing pursuant to assignment. Avco Financial Services appeared through its representative Douglas Buchholz and its attorney, Richard Hansen. Debtor/Defendant Dale Langreck appeared in person with his attorney, Gary McClintock. 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

Debtor Dale Langreck filed a Chapter 7 petition on August 11, 1997. Plaintiff Avco Financial Services of Denison, Inc., a creditor, filed this complaint to determine dischargeability on November 14, 1997. Avco asserts that on March 21, 1997, Debtor provided Plaintiff a Statement of Indebtedness which was materially false and upon which Plaintiff relied in granting Debtor a loan. Plaintiff seeks a determination of nondischargeability under 11 U.S.C. §523(a)(2).

FINDINGS OF FACT

The evidence establishes that Debtor and Avco had a relationship dating from 1991. Debtor borrowed money from Avco periodically prior to the loan in question. Mr. Douglas Buchholz was branch manager of Avco Finance Services in Waterloo, Iowa in 1997. Before March, 1997, Mr. Buchholz had contact with Debtor on several occasions, primarily when a loan had become delinquent. In March of 1997, Debtor had an outstanding loan to Avco on which he made monthly payments.

On March 10, 1997, Debtor phoned Avco seeking additional credit. Debtor talked to Mr. Buchholz who took a phone application. (Plaintiff's Exhibit 3). Mr. Buchholz testified that when a phone application is taken, the person taking the application gets the basic information from Avco's computer, such as name, address, prior loans and other information which is in Avco's possession. Thereafter, Avco asks the loan applicant about present status of employment, changes in collateral,

and other financial information. Mr. Buchholz testified that the most important information to request at that time concerns outstanding debt obligations. Mr. Buchholz was aware of the Avco obligations from the computer and questioned Debtor about any other outstanding obligations.

Mr. Buchholz testified that he then made a credit bureau balance analysis. He testified that the "capacity limit" for a loan ordinarily is 60%. Based on the information provided to him by Debtor, his "capacity limit" was 68% making the loan approvable. Thereafter, Mr. Buchholz obtained a credit bureau check. The credit bureau information and the financial statement provided by Debtor reconciled fairly well. There was no reference in the credit bureau check to a loan at Citizen's State Bank.

Based upon the information provided, Mr. Buchholz scheduled a meeting for March 27, 1997. Before closing on the loan on that date, Mr. Buchholz and Debtor went over information in a document entitled Statement of Indebtedness. (Plaintiff's Exhibit 4). During this process, Debtor had the document. Mr. Buchholz and Debtor went over the entire statement and Debtor wrote all of the information on the sheet.

During this process, Debtor did not inform Mr. Buchholz that he had outstanding indebtedness to Citizen's State Bank. The testimony reveals, and Debtor admits, that he received a loan in October of 1996 from Citizen's State Bank (n/k/a Hawkeye Bank) in the amount of $13,500. In making this loan, Debtor had given Citizen's State Bank a security interest in tools which he owned. The record reveals that the Citizen's State Bank obligation is by far Debtor's largest obligation. His monthly payment to Citizen's Bank for this loan was $338.00. This is a significant payment for Debtor based on his $1,880 monthly gross income.

Mr. Buchholz testified that it is the policy of Avco to rely more on a credit applicant's ability to repay than on outstanding indebtedness. Here, if the Citizen's State Bank obligation were known, it would have placed Debtor's "capacity limit" in the low 50% range and Avco would have denied approval of the loan. Mr. Buchholz testified that accurate information would have required him to turn down the loan. In fact, Mr. Buchholz testified that previously Avco had turned down a request by Debtor when Debtor did not meet the percentage requirements. (Plaintiff's Exhibit 9).

The record additionally reflects that Debtor made several payments to Citizen's State Bank in the amount of $338 before essentially defaulting on that loan. Debtor made one payment to Avco before defaulting on the March 1997 loan.

At the time of approval of the loan in question, Debtor had an outstanding loan with Avco. Debtor financed a total of $3,290.08. Of this total amount, Debtor was directly given a check in the amount of $307.55. Avco sent checks to John Falb's Ford in the amount of $811.91 and to Neowa FS in the amount of $327. These checks paid off Debtor's obligations to those creditors. Avco withdrew the sum of $430.73 as credit insurance. Finally, Avco applied the sum of $1,412.89 to pay off Debtor's previously existing Avco account (No. 596801392). Therefore, the new cash acquired by Debtor in this transaction was the sum of $1,446.40 which constituted the direct payments by Avco to John Falb Ford and Neowa FS as well as the direct payment to Debtor in the amount of $307.55. The remaining amount existed as a result of the prior loan with Avco and the credit insurance payment. Debtor's prior account with Avco was opened in April 1995 for 36 months with monthly payments of $105.94.

Avco does not assert that the previous loan was originally acquired as a result of fraudulent misrepresentation. It is only the loan of March 27, 1997 which is alleged to be based upon a false financial statement. Debtor does not deny that he failed to inform Mr. Buchholz of the outstanding

obligation to Citizen's State Bank. He testified that he simply never gave this obligation a thought. He stated he was always in a hurry and it never occurred to him to provide this information. He testified that he did not intentionally try to deceive Avco Finance.

CONCLUSIONS OF LAW

Plaintiff bears the burden to prove the elements of its claim under 11 U.S.C. §523(a) by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (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). In enacting §523(a)(2), it is unlikely that Congress would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud. Cohen v. De la Cruz, 118 S. Ct. 1212, 1219 (1998).

Avco relies on the following provision 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.

FALSE FINANCIAL STATEMENT

Nondischargeability is established under §523(a)(2)(B) upon proof of the following elements: (1) the debtor made a written statement; (2) it is materially false; (3) the statement is respecting the debtor's financial condition; (4) the creditor reasonable relied on the statement; and (5) the debtor made the written statement with an intent to deceive. See In re Grisham, 177 B.R. 306, 309 (Bankr. W.D. Mo. 1995). This Court has stated that evidence of 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).

As to the first and third elements, it is undisputed that Debtor made a statement in writing respecting his financial condition. This is established by Avco's exhibits reproducing Debtor's Statement of Indebtedness and Avco's application for credit.

Avco Finance has established, by a preponderance of evidence, that the written statement provided by Debtor to Avco on March 27, 1997 was materially false. The obligation to Citizen's State Bank was the largest debt owed by Debtor. It was material to Avco's determination of whether or not additional credit would be granted to Debtor. Mr. Buchholz testified that if the information concerning Citizen's State Bank had been within its knowledge at the time of the loan, Debtor would have fallen below a percentage on which Avco would grant a loan.

The record establishes that Avco reasonably relied upon the information. As previously discussed, Avco has a system whereby an analysis of the ability to repay is determined. Avco accepted the information provided by Debtor and upon the basis of this information, the loan was approvable. However, if the information had been accurate, the ability to repay would have been below limits which Avco would authorize. Based upon the incorrect information, Avco reasonably relied on the inaccurate financial statement to approve this loan. As such, it is established by a preponderance of evidence that Avco relied on this information in granting the loan to Debtor on March 27, 1997.

Avco's reliance upon the information provided by Debtor was reasonable under all of the circumstances. Avco took the basic information by telephone. An inquiry was made by Avco to a credit bureau which reflected certain information though it did not reflect Debtor's obligation owed to Citizen's State Bank. Thereafter, Avco again made an in-person written inquiry of Debtor concerning his assets and obligations. Again, Debtor failed to disclose this critical piece of information. It is clear that Avco used reasonable efforts to discern the veracity of Debtor's financial condition and its reliance on his statement was reasonable under all of the circumstances.

The final issue is the intent of Debtor to deceive Avco Finances. Debtor's sole defense is that he was constantly in a hurry and failed to think of his obligation to Citizen's State Bank. However, the record also reveals that Debtor had been dealing with Avco Finance for some time. He was, in general terms, aware of the method which was used by Avco to determine whether he was a qualified candidate for a loan. He was in a position to understand that if his current obligations exceeded a certain level he would not be able to obtain additional funds. In fact, on at least one prior occasion, he had made an application for a loan and was turned down precisely on this basis. Therefore, he was aware of the repercussions of having an overextended debt load.

Additionally, Debtor's denial of intent to deceive is simply not credible under all of the circumstances. The obligation to Citizen's State Bank is not a small obligation which had been in existence for a substantial period of time. In fact, this is Debtor's largest obligation and was acquired five months or less before the application for the present loan from Avco. Under all of the circumstances presented in this case, the Court concludes that Debtor knew of the existence of this obligation and knew of his responsibility to make its existence known to Avco. It is the conclusion of this Court that Debtor intended to deceive Avco and thereby acquire an additional line of credit even though he was not making payments to Citizen's State Bank on a regular basis.

Avco has established by a preponderance of evidence every element necessary to establish that Debtor made a false financial statement to Avco Finance in order to obtain credit. Avco has, therefore, met its burden of proof to establish nondischargeability under §523(a)(2)(B).

"TO THE EXTENT OBTAINED BY"

The parties dispute the amount of debt which is subject to the §523(a)(2)(B) exception from discharge. The total amount of the loan Avco made to Debtor on March 27, 1997 was $3,290.08. Avco applied $1,412.89 of this amount to pay off Debtor's previous loan. The amount of new credit Debtor actually received from the transaction was $1,446.46. Also included in the total amount of the loan was $430.73 for credit insurance. The issue for determination is whether the total amount of the March 27, 1997 loan should be excepted from discharge or whether the nondischargeable amount should be limited to the new credit Debtor received when he gave Avco the false financial statement.

A threshold requirement under §523(a)(2), is the existence of debt for money or credit "to the extent obtained by" a debtor's false financial statement. The Supreme Court recently considered this language in the context of deciding whether treble damages awarded based on a debtor's fraudulent conduct are included in the amount nondischargeable under §523(a)(2)(A). Cohen, 118 S. Ct. at 1214. The Court held that under §523(a)(2), "'any debt . . . for money, property, services, or . . . credit, to the extent obtained by' fraud encompasses any liability arising from money, property, etc., that is fraudulently obtained, including treble damages, attorney fees, and other relief that may exceed the value gained by the debtor." Id. Once it is established that specific money, property or credit is obtained by fraud, any debt arising therefrom is excepted from discharge. Id.at 1216. The Court noted that in Field v. Mans, 516 U.S. 59, 61 (1995), it described §523(a)(2)(A) as barring discharge of debts "resulting from" or "traceable to" fraud.

Applying this law, the Court must determine the extent to which Avco's total claim arose from, is traceable to, or resulted from Debtor's false financial statement. Obviously, the new credit Avco granted Debtor of $1,446.46 arose from the false financial statement and is nondischargeable under §523(a)(2)(B). The Court also finds the amount of $430.73 for credit insurance also was expended as a result of Avco's reliance on Debtor's false financial statement. The remaining question is whether the $1,412.89 Avco applied to pay off Debtor's existing Avco account balance should also be excepted from discharge. In other words, this Court must determine whether this amount of credit "arose from, is traceable to, or resulted from" Debtor's false financial statement. In In re Anderson, 29 B.R. 184, 193 (Bankr. N.D. Iowa 1983), this Court recognized that notes rolled over by a creditor after receiving a false financial statement may be nondischargeable under §523(a)(2)(B). This is true even though the creditor had not issued any fresh cash along with the rollover of the note. Id. It is not equitable, however, for a debtor to be deprived of discharge on all debt to a particular creditor, simply because a small portion was procured dishonestly. In re Hunter, 771 F.2d 1126, 1130 (8th Cir. 1985). The Eighth Circuit felt that would be an inappropriately punitive application of §523(a)(2). Id.

In Van Horne, the Eighth Circuit declared an entire debt nondischargeable under §523(a)(2)(A). It held the refinancing of the entire debt constituted the damage proximately caused by the debtor's deceit. 823 F.2d at 1289. When the creditor renewed a note based on the debtor's deceit, the creditor waived her right to foreclose on the original debt, postponed the maturity date, and altered the interest rate. Id. The original note was past due when the parties discussed new arrangements and the creditor accepted the new note. Id.at 1286.

Here, Debtor's prior obligation to Avco was not past due at the time Debtor applied for additional credit. The record does not present any apparent reason for Avco to pay off Debtor's existing account at the time he requested new credit. The record does not answer whether the rollover of the old credit was requested by Debtor or simply executed by Avco as a standard procedure. Further, the record fails to document any changes in credit terms between Debtor's old account and the loan created in March 1997.

One court has found the full debt nondischargeable in similar circumstances. In re McFarland, 84 F.3d 943, 947 (7th Cir.), cert. denied, 117 S. Ct. 302 (1996). It holds that the part of the old debt refinanced in the new loan is nondischargeable through the plain meaning of the statute including within its purview "an extension, renewal or refinancing of credit". Id. The court concluded that the statute contains no "detriment" requirement to include the old credit in the amount excepted from discharge. Id. Likewise, the court in In re Goodrich, 999 F.2d 22, 25 (1st Cir. 1993), stated that the only detriment required to be shown is the renewal of credit. In McFarland, the creditor used its typical method of paying off previous debt when the debtor was approved for new credit. In Goodrich, the debtor gained refinancing of a line of credit which was renewable annually with the requirement of a new financial statement.

Other courts, however, have focused on the "to the extent obtained by" language of §523(a)(2) to determine whether a renewal or refinancing is nondischargeable. See In re Norris, 70 F.3d 27, 29 (5th Cir. 1995) (holding amount of credit at annual renewal subject to approval nondischargeable); In re Gerlach, 897 F.2d 1048, 1052 (10th Cir. 1990) (remanding for determination of amount of extension of credit the court can reasonably estimate as being obtained by the fraud). Still other courts have concluded that a creditor must show it incurred damage proximately resulting from the debtor's misrepresentation in extending, renewing or refinancing credit. In re Kim, 163 B.R. 157, 161 (B.A.P. 9th Cir. 1994), aff'd, 62 F.3d 1511 (9th Cir. 1995); In re Siriani, 967 F.2d 302, 306 (9th Cir. 1992) (holding creditor must show it had valuable collection remedies which later lost value); In re Collins, 946 F.2d 815, 816 (11th Cir. 1991) (stating causation requirement implied in §523(a)(2)(B) requires creditor to show it sustained a loss as a result of the debtor's misrepresentation).

From these contradictory authorities, this Court concludes that the requirements of §523(a)(2)(B) include proof of some type of detriment to a creditor for a debt for an extension, renewal or refinancing of credit to be declared nondischargeable. See In re Richards, 81 B.R. 527, 530 (Bankr. D. Minn. 1987) (requiring proof of detrimental reliance as opposed to proof of damages; "harmless fraud" or "fraud in the air" is not a basis for nondischargeability); Van Horne, 823 F.2d at 1289 (finding entire debt constitutes the damage proximately caused by the debtor's deceit). Although the words "detriment" and "damage" are not included in the language of the statute, these concepts inhere in the requirements that the debt is for credit "to the extent obtained by" a debtor's false financial statement and that the creditor "relied" on the statement. The Court must determine whether Debtor obtained Avco's rollover of his existing account by giving the false financial statement and whether Avco relied on the false financial statement in applying a portion of the new loan to pay off the old debt.

The dischargeability of a debt renewed by a creditor at the time of advancing additional credit was addressed in In re Carter, 11 B.R. 992 (Bankr. M.D. Tenn. 1981), as follows:

When renewals are forced on debtors, either as a result of finance company policy or state regulation, neither are the renewals obtained by the debtor nor do the creditors rely on the statements in the renewal process. Debtors only intend to obtain the additional cash advances, not the renewals, and the creditors only rely on the statements in making the advances, not in renewing the prior loans, which are renewed as a consequence of the decision to make the new loans. In such situations, the renewed portion of the debt does not come within the scope of ... §523(a)(2)(B).

Id.at 996 (emphasis in the original).

The record does not establish that Debtor obtained the rollover of his old credit by giving Avco the false financial statement. Debtor requested additional credit. Avco appears to have initiated the

refinancing of Debtor's old credit. There is also no proof that Debtor's false financial statement played any part in Avco's decision to pay off Debtor's existing account when he applied for new credit. If Avco had refused Debtor additional credit based on an accurate financial statement at the time, the old credit would have continued to exist. There is no showing that Avco has suffered a detriment regarding the old credit of $1,412.89.

This Court recognizes that its conclusion is contrary to that reached by the Seventh Circuit in McFarland, 84 F.3d at 947. That court found the plain meaning of §523(a)(2)(B) includes all refinancing in the nondischargeable balance without a "detriment" requirement. Id. While the Eighth Circuit has not directly resolved the issue, to the extent that it has addressed it, it appears their analysis is inconsistent with the Seventh Circuit. The Eighth Circuit rejected the "all or nothing" approach in Hunter, finding it unduly punitive. 771 F.2d at 1130. It does not appear that the McFarland result would be followed in this Circuit and this Court so holds. Based on this analysis, the Court concludes that Debtor's obligation to Avco is dischargeable in the amount of $1,412.89. This amount constitutes the amount of old credit Avco rolled over into the new loan. The remainder of the new loan is nondischargeable under §523(a)(2)(B) as traceable to Debtor's false financial statement.

WHEREFORE, Plaintiff Avco Financial Services' complaint is GRANTED IN PART and DENIED IN PART.

FURTHER, Debtor's obligation to Avco is dischargeable in the amount of $1,412.89.

FURTHER, the remainder of Debtor's obligation to Avco is nondischargeable under §523(a)(2)(B).

SO ORDERED this 15th day of September, 1998.

PAUL J. KILBURG

Paul J. Kilburg
U.S. Bankruptcy Judge