

In the United States Bankruptcy Court

for the Northern District of Iowa

DEBORAH J. ARENSDORF
aka DEBBIE KIEFER
aka DEB CONNOLLY

Bankruptcy No. 99-00003-D

Debtor(s).

Chapter 7

ROXANNE McDOLE

Adversary No. 98-9038-D

Plaintiff(s)

vs.

DEBORAH J. ARENSDORF

Defendant(s)

ORDER

This matter came on for trial on November 16, 1999. Plaintiff Roxanne McDole was present and represented by Attorney Tom Bitter. Defendant Deborah Arensdorf was present and represented by Attorney James O'Brien. Evidence was presented after which the Court took this matter under advisement. The time for filing briefs is now past and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I).

STATEMENT OF THE CASE

Defendant Deborah Arensdorf filed her Chapter 7 petition on January 4, 1999. Plaintiff Roxanne McDole filed her complaint to determine dischargeability on March 31, 1999. Plaintiff alleges that her claim is nondischargeable under 11 U.S.C. 523(a)(2)(A). Plaintiff's claim arises out of a default judgment entered in favor of Plaintiff and against Defendant/Debtor in Iowa District Court for Dubuque County in the amount of \$121,253 in actual damages and \$100,000 in punitive damages.

In the State Court action, as well as in this adversary, Plaintiff alleges that Defendant obtained money from Plaintiff through "false pretenses, a false representation, or actual fraud, other than a debtor's statement respecting the debtor's or insider's financial condition..." 11 U.S.C. §523(a)(2)(A). Defendant denies making any fraudulent representations and asserts that any obligation owed is dischargeable under §523.

Plaintiff filed a petition in Iowa District Court on April 2, 1998 alleging "ruse, fraud, deception, and misrepresentation" by Defendant. Defendant was served with an original notice on April 14, 1998. When no answer was timely filed, the Iowa District Court entered a default on May 19, 1998. A damages hearing was held on July 9, 1998 and on July 15, 1998 a judgment was entered in favor of Plaintiff and against Defendant in the amount of \$121,253 in actual damages and \$100,000 in punitive

damages. Thereafter, Defendant moved to set aside the judgment. After a full hearing, the motion to set aside the State court judgment was denied.

On April 30, 1999, Plaintiff filed a Motion for Summary Judgment in this adversary proceeding. In a ruling entered June 21, 1999, this Court determined that the record made in the Iowa District Court failed to satisfy the second and fourth elements of fraud as defined in §523(a)(2)(A). As such, the Motion for Summary Judgment was overruled and the matter proceeded to trial on November 16, 1999 to determine whether this judgment is dischargeable under Bankruptcy law.

FINDINGS OF FACT

Defendant/Debtor Deborah Arensdorf is married to Glenn Arensdorf. In 1996, Debtor and her husband purchased a parcel of real estate located in Peosta, Iowa, as tenants in common. The parties resided on the second floor of this building and operated a tavern known as the "Hitching Post Saloon" on the main floor. Plaintiff asserts that Defendant was the owner and operator of this tavern. Defendant asserts that, while the real estate may have been held as tenants in common, the tavern belonged to her husband and she simply operated the establishment. Resolution of this factual dispute is unnecessary for a determination of issues in this case.

Plaintiff testified that her birthday is on December 7 and she first met Defendant on that date in 1996 when she attended a birthday party at the Hitching Post Saloon. It appears that a close friendship ensued and Plaintiff testified that they became "buddy-buddy" starting in January of 1997. Soon after Plaintiff and Defendant met, Plaintiff began to purchase items for Defendant and the tavern and give Defendant cash. Plaintiff does not remember the exact date when the first exchange occurred. There appears to be no dispute that, at the times in question, the tavern was having financial problems. Plaintiff testified that Defendant told her that she would lose the tavern if she didn't have help. Plaintiff provided this financial help. From December of 1996 into 1997, she purchased alcohol, pop, and beer for the tavern. She went to K-mart and purchased bar glasses and ash trays for the tavern. She purchased food items from Hy-Vee and Schwann's which were used to a substantial extent in the tavern business. On February 4, 1997, she paid the fire insurance premium for the tavern. She also gave Defendant what is generally conceded to be a substantial amount of cash between December, 1996 and April, 1997, though the exact amount is undeterminable from the record.

Defendant acknowledges these contributions by Plaintiff but generally takes the position that these were gifts or loans made by Plaintiff to Defendant. Plaintiff, however, takes the position that these transactions were part of an arrangement arrived at between Plaintiff and Defendant in which it was intended that Plaintiff would become a business associate in the tavern. While not specific about the exact timing, Plaintiff testified that during the period between December, 1996 and April, 1997, Defendant brought up and discussed with Plaintiff on various occasions the idea that Plaintiff would become a "silent partner".

Plaintiff's parents died in 1995 and Plaintiff was aware that she would be receiving an inheritance. However, it was not until 1997 that she went to a Court hearing with Defendant and found out approximately how much money she would receive from her parents' estate. On April 25, 1997, Plaintiff testified that she unexpectedly received the inheritance check in the mail. It was in the amount of \$184,545.50 and drawn on Firststar Bank. She thought it would be arriving several months later. She received the check sometime between 9:30 and 11:00 a.m. She immediately picked up Defendant and took the check to Firststar Bank. There she met with Mr. Mark Casel, a Bank employee.

Plaintiff gave him the check and they discussed all of the various options. Mr. Casel testified that he did not smell alcohol and both Plaintiff and Defendant appeared competent.

Because of the amount of money involved in the distribution which was proposed, Mr. Casel made some inquiry. Both Plaintiff and Defendant explained to him something to the effect that they were like sisters and they wished the money to be divided. He recalls that both Plaintiff and Defendant used the term "sister". There was no explanation provided to Mr. Casel as to why the funds were being distributed in the manner they ultimately were. From the \$184,000 check, \$25,000 was placed into the Hitching Post Saloon account, \$55,000 was placed in a new savings account in the name of Defendant, and \$15,000 was used to purchase a cashier's check which was ultimately used to purchase a truck for Glenn Arensdorf. While unexplained in the record, the remainder was apparently deposited in Plaintiff's account in her own name.

There was no controversy over money until the friendship between Plaintiff and Defendant came to an end. Plaintiff testified that she and Defendant did have a falling out. She stated that, at one point, Defendant told her to leave the tavern and not return. Plaintiff testified that she never understood why she was asked to leave. She only returned one time after that, with police officers, to pick up certain things which she had left at the tavern. Defendant testified that the reason the relationship ended was because Plaintiff and three other individuals were observed using drugs in the back room of the tavern. Because of this drug usage, she kicked Plaintiff out of the tavern.

Plaintiff testified that shortly before she was kicked out of the tavern, she and Defendant tried to set up a meeting. Plaintiff testified that she anticipated getting her money back if the tavern was ever sold. They attempted to meet over a two month period and eventually met at the Country Kitchen on an unspecified date. Plaintiff asserts that, at this meeting, they talked about repayment of the funds. Defendant admits that they had coffee at the Country Kitchen but denies that any discussion was held concerning repayment.

Plaintiff states that her payment of sums of money between the end of 1996 and into 1997 were premised upon the fact that Defendant told her that she would be a "silent partner" in the tavern business. She said that these conversations probably began in February, 1997. The term "silent partner" or what the parties intended to be meant by that term is never explained in the record. Plaintiff alleges that this arrangement was discussed many times. She asserts nobody else was to know about their agreement. She testified that it was Defendant's idea that she would be a "silent partner" because the business needed financial support. Plaintiff testified that she did not feel that she was responsible as a "silent partner" for any of the past debts of the establishment.

Plaintiff states that she would not have given Defendant money as a gift. She testified that she would not have purchased other things for the tavern and would not have paid the insurance premiums for the tavern except for her understanding that she was a part owner of the tavern. As a "silent partner", Plaintiff was to allegedly receive \$600 or more per week in profits from the business. No weekly payments were ever made by Defendant to Plaintiff. None of these transactions were ever reduced to any type of writing. Plaintiff testified that, at some point, she herself considered the money to be a loan and not an ownership interest.

Defendant acknowledges that Plaintiff was generous. However, Defendant asserts that she never made any representations that Plaintiff would become a business associate or a "silent partner". Defendant testified that the attitude of Plaintiff with her money towards Defendant was the same as with many other individuals in Plaintiff's life. There is testimony that Plaintiff paid \$25,000 in bail money to get a William Ogelsby released from jail on drug charges. There is testimony that she also gave him other

gifts and a car. There is testimony that Plaintiff paid for her brother's wedding and made other gifts to her brothers. She allegedly financed an extended trip to Florida for herself and others. She used \$15,000 of the inheritance check to purchase a truck for Glenn Arensdorf. There is also testimony in the record that she purchased a car for Defendant's son and his girlfriend. Defendant testified that she paid back some of the funds and did other things for Plaintiff in return for her generosity. However, she asserts that at no time did she represent that Plaintiff would be a partner in the tavern.

The evidence reflects that eventually the Hitching Post Saloon business failed and is no longer in operation.

523(a)(2)(A)

Plaintiff asks the Court to determine that her claim is nondischargeable pursuant to §523(a)(2)(A). A court may declare an individual debt nondischargeable if the debtor incurred the debt for money obtained through "false pretenses, a false representation, or actual fraud, other than a debtor's statement respecting the debtor's or an insider's financial condition...." 11 U.S.C. 523(a)(2)(A). The Court must construe this exception narrowly against the creditor and liberally in favor of the debtor. In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987). Under §523(a), the creditor bears the burden of establishing the elements of nondischargeability by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 283 (1991).

To establish that a debt is nondischargeable under §523(a)(2)(A), the creditor must show that:

- a. the debtor made false representations;
- b. at the time made, the debtor knew them to be false;
- c. the representations were made with the intention and purpose of deceiving the creditor;
- d. the creditor justifiably relied on the representations; and
- e. the creditor sustained the alleged injury as a proximate result of the representations having been made.

Van Horne, 823 F.2d at 1287 (as modified by Field v. Mans, 516 U.S. 59, 74-75 (1995)); In re Schlitter, Adv. No. 98-9072-D, slip op. at 3 (Bankr. N.D. Iowa May 14, 1999).

A statement regarding future performance, such as the payment of an obligation, is only fraudulent if the party making the statement did not intend to perform when the statement was made. In re Hyman, 219 B.R. 699, 702 (Bankr. D.S.C. 1998). A debtor's failure to make any payments on an obligation is insufficient by itself to allow the Court to infer that the debtor did not intend to repay the obligation at the time the debtor incurred the obligation. Id.

An affirmative statement is not necessary to establish fraud under §523(a)(2). A court may find fraud through silence if the debtor knows that the creditor is making a loan relying on a misconception and the debtor does nothing to correct that misconception. See Van Horne, 823 F.2d at 1288; In re Moen, 238 B.R. 785, 791 (B.A.P. 8th Cir. 1999).

Plaintiff alleges that Defendant fraudulently induced her to make payments of money to Defendant over a period of time based upon the representation made by Defendant that Plaintiff would be made a "silent partner" in the business of the Hitching Post Saloon.

CONCLUSIONS

The first element of a claim under §523(a)(2)(A) is that Defendant made a false representation. Plaintiff has alleged three fraudulent statements. She alleges that Defendant promised her that Plaintiff would be made a "silent partner" in the business. Additionally, Plaintiff alleges that after the loans were made and after the friendship of the parties had terminated, Defendant stated first that she was dying, and secondly, that Plaintiff would get everything in her Will. The last two statements were made after all financial interaction had terminated. By that time, Plaintiff was seeking some type of reimbursement.

Fraudulent statements, if made, must be relied upon and must be a proximate cause of any damage suffered. Based upon the timing of these alleged comments by Defendant, it is apparent that any statements made by Defendant concerning her death or that she was going to leave Plaintiff everything in her Will could not have induced Plaintiff to act nor could it be a proximate cause of damage. Thus, these two statements, even if made, do not satisfy any element of fraud.

The sole representation made by Defendant which is relevant to these facts is whether she told Plaintiff she would become a "silent partner" in Defendant's business in return for her various contributions of goods and cash to Defendant. Whether or not Defendant actually had an ownership interest in the tavern is irrelevant to the issues presented. Whether Defendant made a fraudulent misrepresentation and whether Plaintiff relied upon this representation are the critical questions in the case. There need be no determination as to whether Defendant had an actual ownership interest to relinquish.

Plaintiff alleges that Defendant offered to make her a "silent partner" on numerous occasions between February and April, 1997. The evidence reveals no writing of any kind to establish this alleged commitment. There is apparently no other person who was aware of the alleged business relationship. The issue ultimately must be decided based on Plaintiff's assertion that Defendant promised her a "silent partner" interest in the business and Defendant's denial that this promise was ever made.

The only other fact having evidentiary impact on the issue is the fact of the transfer of money. How this is viewed is of considerable importance in deciding the ultimate issue. There is some evidentiary support for three options. The transfers could be categorized as (1) gifts, (2) loans, or (3) a sale of part of Defendant's interest in the business. The fact that substantial amounts of money were given by Plaintiff to Defendant may ordinarily be evidence of a business transaction and not a gift. Because of the amount of money involved, one would not be inclined to think that this was a gift. However, Plaintiff's relationship with Defendant and other acquaintances defies easy definition. Plaintiff has historically been willing to give friends, acquaintances, and relatives large sums of money with few or ambiguous conditions for repayment. Therefore, in the context of Plaintiff's other financial transactions, the fact that she gave Defendant substantial amounts of money is not particularly instructive on the nature of this transaction.

There is some evidence to indicate that a part or all of the transfers were loans. Plaintiff herself, at one point, testified that she considered these transfers to Defendant to be loans. It appears that Defendant repaid some of the funds over the course of time. Certain of both Plaintiff's and Defendant's testimony could be construed as acknowledging that at least some of the transfers were considered loans and not

gifts. If the relationship was a partnership, it would be reasonable to conclude that Plaintiff would have sought remedies consistent with the breakup of a partnership. However, she testified she desired to meet with Defendant to discuss repayment. This is obviously a remedy more consistent with a loan than a partnership. Additionally, Plaintiff testified that she was to receive \$600 per week. The fact that she was to receive a fixed sum per week instead of a percentage of profit may be construed as indicating a loan. All of these matters create the appearance of a loan rather than a partnership arrangement.

Finally, the transactions could be viewed as a sale by Defendant of an interest in the business to Plaintiff. This is the contention of Plaintiff. She categorizes this as an agreement between herself and Defendant that she would be a "silent partner". A "silent partner" under Iowa law is the same as any other partnership relationship. In order to establish a partnership relationship, there is a four element test which requires that there be an intent by the parties to associate as partners. There must exist a business upon which the partnership is based. The partnership must be established with the goal of earning profits. There must be co-ownership of the profits, property and control of the partnership business. Hameed v. Brown, 530 N.W.2d 703, 708 (Iowa 1995). Intent to create a partnership is the critical element. A partnership need not necessarily be in writing and may be inferred from the conduct of the parties. The elements of an oral partnership are identical to those necessary for a partnership evidenced by a writing. Wahlan v. Connelly, 545 N.W.2d 284, 293 (Iowa 1996).

The burden is upon Plaintiff to establish each element of a claim of fraud under §523(a)(2)(A). It is, therefore, Plaintiff's burden to prove by a preponderance of evidence that a misrepresentation did occur. There exists no documentation of any kind and any oral statement made was solely within the knowledge of Plaintiff and Defendant. Their versions are diametrically opposed. Any attempt to examine the behavior of the parties in an attempt to ascertain what truly occurred leads to conclusions which are murky and as consistent with one version as another. Based upon the record presented, Plaintiff's transfers of money to Defendant could have occurred for numerous reasons. It is Plaintiff's burden to establish that the transfers were induced by a fraudulent misrepresentation made by Defendant. The record, as presented, leads the Court to conclude that Plaintiff has failed to meet her burden of proof in establishing that Debtor made any fraudulent representation.

The Court has concluded that Plaintiff has failed to establish the first element of §523(a)(2)(A). If this burden had been satisfied, the burden would remain on Plaintiff to establish the remaining elements of her claim. The second element requires that Plaintiff establish that Defendant knew the statement was false. The third element requires that Debtor made the misrepresentation with the intention of deceiving Plaintiff. The Court feels that these can be considered together.

As previously discussed by the Court, the conduct of the parties in this entire series of transactions is ambiguous. Their conduct is as consistent with one type of transaction as another. Plaintiff alleges that Defendant made a representation that she would become a "silent partner" in Defendant's business. It is fair to conclude from the testimony presented that the parties did not necessarily understand the intricacies of partnership law. There was no discussion between the parties as to what was intended by the alleged comment. There is no explanation as to whether this was intended to be prospective or to occur immediately. There is no testimony as to whether the parties anticipated that appropriate documents would be drafted to formalize this alleged relationship.

Based upon all of these unresolved questions, it is impossible to conclude that even if a statement was made that it was false or intended to be made with the purpose of deceiving Plaintiff. Based upon the vague and general nature of the statement allegedly made, this Court must conclude that Plaintiff has

failed to establish and meet her burden of proof as to the second and third elements of her §523(a)(2)(A) claim.

The fourth element of this claim requires Plaintiff to establish that she justifiably relied on the representation made. Again, assuming that the statement alleged by Plaintiff was made, the question becomes whether her reliance upon such statement was justifiable under all the circumstances. As previously indicated, the evidentiary record is devoid of any further discussion between the parties as to what precisely was intended by this statement. If it was intended to be the purchase of a partnership interest in this business, it would be fair to conclude that further discussions would be held to define precisely the nature of the relationship. To rely on the comment allegedly made, without reducing the same to writing, seeking legal counsel, or at least clearly defining the terms of the relationship, does not constitute justifiable reliance.

In summary, the exception against discharge under §523(a)(2)(A) is to be narrowly construed against a creditor and liberally in favor a debtor. Plaintiff bears the burden of proof as to each of the elements of nondischargeability in this context. This Court must conclude, based upon a complete analysis of the record, that Plaintiff has failed to establish her burden as to each element of this claim.

WHEREFORE, for all the reasons set forth herein, Plaintiff's complaint against Debtor-Defendant under 11 U.S.C. §523(a)(2)(A) is DENIED.

FURTHER, the obligation owed by Debtor-Defendant Deborah J. Arensdorf to Plaintiff Roxanne McDole should not be excepted from discharge under 11 U.S.C. §523(a) and the same is therefore dischargeable.

SO ORDERED this 16th day of December, 1999.

Paul J. Kilburg
Chief Bankruptcy Judge