In the United States Bankruptcy Court

for the Northern District of Iowa

LARRY L. RANDALL JANICE E. RANDALL *Debtor(s).*	Bankruptcy No. 98-01474-W Chapter 7
FARMERS STATE SAVINGS BANK *Plaintiff(s)* vs. LARRY L. RANDALL JANICE E. RANDALL *Defendant(s)*	Adversary No. 98-9149-W

ORDER

On February 9, 2000, the above-captioned matter came on for hearing pursuant to assignment. Plaintiff Farmers State Savings Bank appeared by Attorney Robert Murphy. Debtor-Defendant Janice E. Randall appeared in person with Attorney Michael Dunbar. Debtor-Defendant Larry L. Randall did not appear. He was represented by Attorney Dunbar. 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 August 12, 1998 and arises from a Chapter 7 petition filed May 15, 1998. Plaintiff asserts that Defendants made false representations to Plaintiff concerning the amount of Defendants" debt which induced Plaintiff to loan money to Defendants. Plaintiff asserts that the representations made by Defendants were false and were made with the intent to deceive Plaintiff into granting Defendants' loan application. Plaintiff seeks a determination that the debt owed to it by Defendants be excepted from discharge pursuant to 11 U.S.C. §523(a)(2)(B). Defendants deny any mirepresentation.

FINDINGS OF FACT

Defendants Larry L. and Janice E. Randall filled out a loan application with Farmers State Savings Bank on December 5, 1997. (Plaintiff's Exhibit A). It was an unsecured loan and was intended as a Christmas Club loan to be repaid at a subsequent time. Since the time of the loan application, Farmers State Savings Bank has changed its name to Banc Iowa with Federal I.D. No. 42-0247350. For the purposes of this opinion, however, the Court will simply refer to Plaintiff as the "Bank".

Brenda Werner is an officer with Banc Iowa. She was also employed when the Bank made the loan. She was the loan officer involved in the loan with Mr. and Mrs. Randall in December, 1997. Ms. Werner testified that upon completion and presentation of the loan application by Defendants, she ran a credit check which did not reveal any significant information inconsistent with that provided by Defendants. She testified that the loan application form is used to calculate a borrower's debt-to-income ratio. This in turn is used to determine their ability to repay a proposed loan. She testified that the Bank relied on Defendants' application in granting this loan. She testified that a proposed borrower's debt-to-income ratio cannot exceed 36% of the borrower's monthly income. Based upon the information available to her at the time of the making of this loan, the loan was approved and was within guidelines established by the Bank.

When Defendants filed their Chapter 7 bankruptcy petition, the Bank observed that the schedules were inconsistent with the loan application prepared five months previously. Ms. Werner testified that the additional obligations listed in the bankruptcy schedules may have changed the debt-to-income ratio so that it would have exceeded 36%.

Ms. Werner testified that she relied upon Defendants' application when considering the original loan and a correct listing of the additional debt would have changed her determination in granting the loan. More specifically, the loan application submitted by Defendants listed five specific debts. Two of these debts were to Farmers State Savings Bank about which the Bank was obviously aware. In addition, Defendants listed a student loan, an obligation to Banc One, and an obligation to Heilig-Meyers. Though not specifically listed as debts, reference is made in the application to several other obligations. These obligations include a mortgage on the parties' home to Household Finance; a co-signer guarantee by Defendants for their son, Thomas Randall on an automobile; and a reference to unpaid and outstanding medical bills.

The schedules filed in the bankruptcy proceeding lists, in one form or another, all of the above-referenced obligations as well as other obligations not listed in the loan application. Of the obligations listed in Defendants' Schedule F, four are collection agencies: Accent Service Company, Credit Bureau Enterprises, ECC, and Xact. These collection agencies were collecting obligations which reference other obligations in the schedules or obligations listed in the original loan application. In addition, there are references to three obligations which Defendant Janice Randall testified were her son's debt. She testified, however, that these were listed in the schedules for protective purposes because their son was a minor at the time these obligations were incurred. They were listed in the event that these creditors attempted to collect against Debtors. These obligations were: Columbia House, Northshore Agency, Inc., and Fingerhut. The schedules listed the obligations disclosed to the Bank in the loan application. These were: Farmers State Savings Bank, the student loan to Iowa Student Loan Corporation, Heilig-Meyers, and the uncollected medical bills to OB-GYN Associates, PC and Covenant Medical Center. The only remaining debt scheduled is a claim listed on Schedule F to Credit First N.A. for merchandise in the amount of $705. Defendant Janice Randall testified that apparently this was for merchandise and that it was a secured credit card though she did not know the exact nature of the merchandise or the obligation. It is not specified in the record whether this obligation was incurred at the time of the presentation of the financial statement to the Bank.

The remaining undisclosed obligation is a tax claim by the Internal Revenue Service in the amount of $5,100. This claim is listed in Debtors' Schedule E but is not revealed in Defendants' application of December 5, 1997. Ms. Werner testified that disclosure of the IRS obligation alone would have prevented approval of the loan in December, 1997 because of Bank rules involving the IRS and the IRS's extraordinary collection powers.

Defendant Larry L. Randall was not present at trial and the testimony provided on behalf of Defendants was by Defendant Janice Randall. She testified that the loan made in December of 1997 was for a Christmas Club loan. While her husband signed the application, she is the most familiar with the parties' finances and provided the information on the application. She stated that her husband is not familiar with the family finances and that he turns over his check to her and she is then responsible for payment of the bills and obligations of the family. At the time she filled out the loan application, she did not have the benefit of a credit report though she tried to fill out the information to the best of her ability. She stated that, in essence, the loan application contains all of the information in the schedules except for collection agencies and obligations which are contingent based upon their son's obligations. The only obligation which may not have been listed is the credit card debt which she testified is a secured debt for which she has no recollection.

She testified concerning the IRS debt. She was the conservator for her brother, Roger Hanson, who has a mental disability. During an unspecified period of time, she herself was having mental and emotional problems. She was charged criminally with conversion of conservatorship assets. She testified that this entire period of time is unclear to her. On advice of counsel, she entered an Alford plea to the charges. As a result of the plea and the subsequent sentencing and restitution hearing, Defendant was ordered to repay these funds. The IRS also became aware of this conduct and treated the converted funds as income. As unreported income, the IRS assessed income tax and penalties which constitute the $5,100 listed in Defendants' Schedule F. Defendant testified that she was not aware at the time of the filing of the financial statement in December of 1997 that the IRS had made this assessment. She testified that she has an agreement with the IRS to pay the sum of $50 per month. Her testimony, however, seems inconsistent because she implied that she was already making the $50 per month restitution payments to the IRS at the time of preparing the loan application.

She testified that this conduct, including other background information, was embarrassing to her and she has been desirous of keeping this episode secret. Some testimony indicates that her husband may not even have been aware of these facts. The record seems to indicate that she did not even disclose this episode to her attorney until it was revealed during her testimony.

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 issue presented is whether Debtors gave false information on their 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 Defendants submitted a financial statement to the Bank in the form of a loan application. This loan application was in writing which satisfies the requirements of §523(a)(2)(B). Defendants do not seriously contend that the loan application does not satisfy this element and the Court concludes that the loan application satisfies 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 Defendants did not list the IRS debt as well as certain other obligations at the time of the making of the application. 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)).

In this case, Plaintiff asserts two general areas where it alleges Defendants made materially false statements. The first relates to debts listed on the bankruptcy schedules which were not listed in the

loan application. The second category relates to the IRS debt. The Court previously discussed the various obligations listed in the bankruptcy schedules. It is the opinion of this Court that Defendants have sufficiently explained all of these obligations. It appears that, with the possible exception of the Credit First obligation in the amount of $705, there exists a rational explanation why the listed obligations were not noted on the loan application. Again, with the exception of the Credit First obligation, there appears to be nothing in the scheduled matters which would be necessary to list in the loan application. As to the Credit First debt, the record fails to establish that this debt existed at the time of the loan application. As such, this Court cannot conclude that the failure to list this obligation was materially false because it is not established that the debt existed at that time. Therefore, as to the scheduled obligations, the Court concludes that Plaintiff has failed to establish that the debts scheduled in the bankruptcy schedules which are different than the loan application are materially false.

The second category relates to the claim by the IRS in the amount of $5,100. It is the conclusion of this Court that this obligation existed at the time of the loan obligation. Defendant Janice Randall was aware of the obligation and because of her desire to keep this information secret, she failed to list this obligation on her credit application. Materially falsity can be based upon the omission of information about a debtor. The omission here to list the $5,100 of the IRS is sufficiently significant to constitute a material falsity by Janice Randall. However, there is no evidence in this record that Defendant Larry Randall was aware of this obligation. It appears that, as Mrs. Randall handled all of the financial affairs of the family, Mr. Randall was unaware that this assessment had been made because of Mrs. Randall's conduct. Thus, while the Court concludes that Mrs. Randall provided a materially false statement, the Court cannot conclude, based upon this record, that Mr. Randall made a materially false statement.

INTENT TO DECEIVE

Plaintiff must establish that Defendants intended to deceive the Bank through Defendants' 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 alsoIn 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.

Here, the record establishes that Defendant Janice Randall intended to deceive the Bank by withholding relevant information. It is possible that she withheld this information as much to avoid the embarrassment of revealing it as she did to secure the loan. Nevertheless, the effect upon the Bank through the withholding of this information is the same. In other words, it is not necessary to establish why Defendant withheld the information, but only that she intended to do so. In this case, the Court concludes that Janice Randall intended to deceive the Bank by withholding information which was material to the Bank's decision whether or not to approve this loan. This record fails to establish that Mr. Randall was aware of the existence of this obligation. As such, the record is devoid of any evidence which would indicate that at the time he helped fill out and execute the loan application, he had any intent to withhold this or any other information from the Bank. Therefore, he had no intent to deceive the Bank in order to gain acceptance of the loan in question.

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 evidence establishes that the Bank exercised normal procedures in having Defendants complete the loan application. There is nothing to indicate that the Bank did so in a casual manner or that the Bank did not intend to rely upon the information contained in the loan application. It is true that the Bank also utilized normal lending procedures by running a credit check. This credit check did not reveal the IRS obligation. Ms. Werner testified that, because of the extraordinary collection powers of the IRS, revelation of the debt to the IRS would have precluded the loan. This information was within the knowledge of Janice Randall and was not revealed in any other manner. This Court concludes that the Bank was justified in relying upon the loan application which would have been the only means available to reveal this critical fact to the Bank. 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 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

It is the conclusion of this Court 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) as against Defendant Janice E. Randall. However, it is further the conclusion of this Court that Plaintiff has failed to establish by a preponderance of evidence that Defendant Larry L. Randall had the requisite knowledge or intent to provide a false financial statement to the Bank. It is the conclusion of this Court that Plaintiff has failed to establish the requisite elements necessary under §523(a)(2)(B) against Larry L. Randall. Accordingly, Plaintiff's complaint requesting that Defendants' debt be excepted from discharge under §523(a)(2)(B) is granted as to Defendant Janice E. Randall and is denied as to Defendant Larry L. Randall.

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 as to Janice E. Randall.

FURTHER, 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 DENIED as to Larry L. Randall.

SO ORDERED this 18th day of February, 2000.

Paul J. Kilburg
Chief Bankruptcy Judge