UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

GARY C. FOOTE and
LISA J. FOOTE,

Debtors.

Case No. 87-2190-C

Adv. No. 87—0250

CREDITHRIFT OF AMERICA, INC.,

Plaintiff,

Chapter 7

v.

GARY C. FOOTE and
LISA J. FOOTE,

Defendants.

ORDER - TRIAL ON COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

On July 12, 1988, a trial was held on the complaint to determine dischargeability of debt. Mark U. Abendroth appeared on behalf of Plaintiff and Susan K. Janssen appeared on behalf of Defendants. At the close of said trial, the Court took the matter under advisement with a briefing deadline of August 19, 1988. Briefs were timely filed and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I). The Court, upon review of the pleadings, arguments of counsel, evidence presented and briefs, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. On September 2, 1987, Defendant Debtors filed a voluntary Chapter 7 petition.

2. On February 16, 1987, Defendants signed an “Application for Loan” when they applied for credit at Plaintiff’s Urbandale office.

3. Defendants originally contacted Norwest Financial for a loan. In checking on Defendants’ Application, Norwest contacted Plaintiff regarding Defendants’ credit history with Plaintiff. Defendant Lisa Foote then received a call from Plaintiff’s employee wondering why Defendants had not made an application with Plaintiff since Defendants already had an existing loan with Plaintiff. The information contained in the application was then given to Plaintiff over the phone. Defendant Lisa J. Foote advised Plaintiff that Norwest’s rate of interest was either 21 or 22% and Plaintiff reduced its rate of interest from 24% to 20.5% or
20.48%.

4. Said application shows that it was a consolidation loan. The application shows $4,412.00 as the total balance due on open accounts although the line items shown could be construed to give a total of $7,762.53. The application shows total monthly payments in the amount of $160.00, although the line items shown could be construed to give a total of $263.00. The application shows that it has been

altered by the use of whiteout. It is not known when this alteration occurred. Said application has been in the possession of Plaintiff at all times material herein.

5. On February 17, 1987, Defendants executed a promissory note with the principal amount financed of $3,955.23, with interest at the rate of 20.48% per annum. Defendants refinanced an existing account with Plaintiff in the amount of $2,463.11 and received “new money” in the amount of $1,117.04. The note provided for 36 payments to pay off $5,361.31 in total payments, which amount includes the finance charge of $1,406.08.

6. Defendants made four payments and filed their Chapter 7 petition in September 1987, when the August payment was past due.

7. Defendant Lisa Foote used a prior credit report in giving the financial information to Plaintiff. Said defendant estimated the current amount of debt using that report as a guide.

8. Defendants offered to give Plaintiff security in the form of motor vehicles, but this offer was refused by Plaintiff.

9. Defendants did not discuss the application with Plaintiff’s employees when they went to Plaintiff’s place of business on February 17, 1987, to sign the application and the promissory note.

10. Defendants' schedules filed with the petition revealed that Debtors declared there were secured claims of $33,679.23 and unsecured claims of $16,560.25.

11. Defendants testified they did not tell Plaintiff about some of the scheduled debts because of oversight, belief that some of the debts had been or were going to be paid by insurance claims, and because some of the debt was contracted after the application was made to Plaintiff.

12. Defendants had the intention of paying off their debt to Plaintiff but they could not afford several medical bills which came due.

13. Plaintiff's employee who drafted the application was not the employee who testified at the trial. The employee who testified at the trial could not testify as to the circumstances surrounding the drafting of the application.

14. Counsel for Defendants has filed a claim for attorney's fees. Counsel claims 24.9 hours in the preparation of pleadings, motions, trial preparation, and the trial of this proceeding. Counsel also claims $51.26 for out—of—pocket expenses. Counsel urges that $50.00 per hour is a reasonable value for her hourly services.

DISCUSSION

The issue in this case is whether Defendants' debt owed to Plaintiff is nondischargeable pursuant to 11 U.S.C. §523 (a) (2) (B). Said section provides:

> (a) A discharge under section 727.. .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 an 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.

11 U.S.C. §523(a)(2)(B). The burden rests upon the creditor to prove each of the elements by clear and convincing evidence. In re Biedenharn, 30 B.R. 342, 345 (Bankr. W.D. La. 1983).

A materially false financial statement under section 523(a)(2)(B) is one containing important and substantial untruth, and what is substantial is a question of fact. Id. In addition, the failure to include outstanding obligations

on a loan application renders the statement materially false. In re Whiting, 10 B.R. 687, 689 (Bankr. E.D. Pa. 1981)

A creditor's reliance on a false representation must be reasonable. In re Kelley, 51 B.R. 707, 709 (Bankr. S.D. Ohio 1985). The determination of reasonableness is made on a case—by—case basis. In re Ardelean, 28 B.R. 299, 301 (Bankr. N.D. Ill. 1983). Reliance is unreasonable when a creditor knows from the outset that a financial statement is inaccurate. In re Jackson, 32 B.R. 549, 552 (Bankr. E.D. Va. 1983); In re Houk, 17 B.R. 192, 195—96 (Bankr. D.S.D. 1982). A creditor has a duty to obtain a correct financial statement that it can rely on if it desires to use that statement at a later time as a basis for determining nondischargeability. Jackson, 32 B.R. at 552.

Intent to deceive requires a knowing and intentional submission of a materially false financial report for the specific purpose of deceiving or defrauding the party extending credit. In re Posick, 26 B.R. 499, 501 (Bankr. S.D. Fla. 1983). Said intent may be presumed from the use of a false financial statement to acquire credit. In re Simpson, 29 B.R. 202, 211 (Bankr. N.D. Iowa 1983). If defendant rebuts the presumption by denying the alleged intent, plaintiff then has the burden of proving the intent. Id. Proof of a debtor's intent to deceive a creditor does not need to be established by direct proof but may be

inferred from the circumstances of the case. Matter of Bonanza Import and Export, Inc., 43 B.R. 570, 575 (Bankr. S.D. Fla. 1984).

In the case at bar, concerning Plaintiff's reasonable reliance, there are several obvious inaccuracies on the loan application. The circumstances of the transaction failed to show Plaintiff actually relied on the financial statement. Plaintiff took the information over the phone and the application was immediately approved. There is no showing that Plaintiff's employee considered the statement to determine the accuracy of the information recorded thereon. There is no showing that the loan would not have been made without the financial statement.

Concerning intent to deceive, there is no showing that Defendants had an actual intent to deceive Plaintiff. In addition, there is no showing that Defendants actually examined the application when they signed it. Finally, there is no showing that the errors on the loan application were such that Defendants knew or should have known of their falsity when they signed the application.

As a result of the above, the Court concludes Plaintiff has failed to show by clear and convincing evidence either reasonable reliance or intent to deceive. Thus, Plaintiff's complaint under section 523(a) (2) (B) should be dismissed.

As part of her argument against Plaintiff's complaint, Defendant's attorney also argued Defendants are entitled to

costs and fees for defending the action. Counsel's argument refers to section 523(d) which states:

> If a creditor requests a determination of dischargeability of consumer debt under section (a) (2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially -justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. §523(d) (emphasis added). The purpose of said subsection is to discourage creditors from bringing actions in hope of obtaining a settlement from an honest debtor anxious to save attorney's fees. Manufacturers Hanover Trust Co. v. Hudgins, 72 B.R. 214, 219 (N.D. Ill. 1987).

A creditor's position is "substantially justified" if the creditor produces some evidence in connection with each element upon which it has the burden of proof. Matter of Van Buren, 66 B.R. 422, 425 (Bankr. S.D. Ohio 1986). Once a creditor learns its position is not substantially justified, the creditor is not justified in continuing to pursue its case, even if the suit was originally filed in good faith. Manufacturers Hanover, 72 B.R. at 221.

In the case at bar, the Court concludes Plaintiff's position was not substantially justified for the following reasons. First, Plaintiff produced no evidence indicating it reasonably relied on the loan application. Second, Plaintiff offered no explanation regarding the discrepancies

on the loan application or the alterations of such. Finally, Plaintiff produced no evidence indicating Defendants filled out the loan application with the intent to deceive Plaintiff. As a result, the Court concludes Defendants are entitled to a judgment for attorney's fees and costs of this proceeding.

Concerning the amount of the judgment, Defendants have requested $1,296.26 for fees and costs incurred by their attorney. This amount is based in part upon an hourly rate of $50.00. The Court concludes the amount of the request is reasonable based upon the time spent upon pleadings, motions, trial preparation and the conduct of the trial.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Plaintiff failed to meet its burden of proving by clear and convincing evidence the elements of its complaint under 11 U.S.C. §523(a) (2) (B).

IT IS ACCORDINGLY ORDERED that Plaintiff's complaint is dismissed and that Defendants' debt owed to Plaintiff is dischargeable.

IT IS FURTHER ORDERED that Defendants have judgment against Plaintiff dismissing the complaint and for costs, which include reasonable attorney's fees, in the amount of $1,296.26.

Dated this 30th day of September, 1988.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE