UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

BRIAN EUGENE PAVELKA and
DIERDRE LEE PAVELKA,

Debtors.

Case No. 87-3080-W
Chapter 7

Adv. No. 88-0057

MILLS COUNTY STATE BANK,

Plaintiff,

V.

BRIAN EUGENE PAVELKA and
DEIRDRE LEE PAVELKA,

Defendants.

JUDGMENT

The issues of this proceeding having been duly considered by the Honorable Russell J. Hill, United States Bankruptcy Judge, and a decision having been reached,

IT IS ORDERED AND ADJUDGED that the obligation of Defendant, Deirdre Lee Pavelka, to the Plaintiff, Mills County State Bank, in the amount of $2,852.73, plus interest, is non-dischargeable under §523 (a)(2)(B).

Dated this 9th day of December, 1988.

Mary M. Weibel
Clerk of U.S. Bankruptcy Court

By: _____
Deputy Clerk

SEAL OF U.S. BANKRUPTCY COURT
ENTRY OF JUDGMENT
Dated: December 9, 1998

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MILLS COUNTY STATE BANK,

Plaintiff,

V.

BRIAN EUGENE PAVELKA and
DEIRDRE LEE PAVELKA,

Defendants.

ORDER--TRIAL ON COMPLAINT OBJECTING TO DISCHARGEABILITY OF DEBT

On August 25, 1988, a trial was held on the complaint objecting to dischargeability of debt. James A. Thomas appeared on behalf of Plaintiff Mills County State Bank (hereinafter "Bank") and H. Walter Green appeared on behalf of Defendant Deirdre Lee Pavelka (hereinafter "Defendant"). At the conclusion of said hearing, the Court took the matter under advisement upon a briefing deadline of September 30, 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 admitted and briefs, now enters its findings and conclusions pursuant to F.R. Bankr. P. 7052.

FINDINGS OF FACT

1. On December 21, 1987, Defendant filed a joint voluntary Chapter 7 petition.

2. On June 30, 1986, Bank loaned Defendant $10,005.00, in return for which Defendant gave Bank a promissory note for $10,005.00. Defendant borrowed this money for the stated purpose of purchasing business equipment and for operating expenses.

3. On July 23, 1987, Bank advanced Defendant an additional $2,852.73, and refinanced the first loan which had an outstanding balance of $7,147.27, for a total new loan of $10,000.00.

4. As part of the consideration and as an inducement to Bank to make the loan, Defendant filled out a written financial statement on July 15, 1987, wherein she listed her total liabilities as $16,600.00, and her contingent liabilities as $13,000.00.

5. On July 15, 1987, Defendant had the following joint liabilities that she failed to list on her written financial statement for Bank: 1) first mortgage on home for $28,750.00; 2) second mortgage on home for $3,357.72; 3) AVCO Finance for $2,186.00; and 4) note to Larry and Peggy Kruse for $3,546.79.

6. Because of the above omissions, Defendant under-

stated her liabilities by $37,840.51 on the written financial statements she supplied to Bank.

7. Defendant gave her projected annual income in the amount of $30,000.00-$35,000.00, and listed child support in the amount of $3,600.00, as other income.

8. At the time Defendant gave the financial statement to Bank, Defendant was employed as an insurance sales agent. She had past experience in filling out financial statements and obtaining loans. She had been employed as an accounting clerk working with accounts payable, and had three years of advanced schooling toward an accounting major.

9. At the time Defendant filled out the financial statement, she knew: 1) what the financial statement was; 2) what it was used for; 3) who her creditors were and the amount of the respective debts; 4) she was responsible for the debts; and 5) these debts were not disclosed on the financial statement and that she had not disclosed them to Bank's loan officer or other employee of Bank.

10. Defendant stated she was separated and "almost divorced." Defendant was not receiving child support from her estranged husband at the time of the financial statement. Defendant did not reveal to Bank any proposed division of debt in the pending dissolution of marriage proceeding.

11. Bank used the following factors in agreeing to advance the additional monies to Defendant: 1) her present income; 2) her present obligations; and 3) her payment history. The financial statement as prepared and presented by Defendant was used as an integral part in determining her present income, present financial obligations, and ability to pay additional debt.

DISCUSSION

The issue in this case is whether Defendant's debt owed to Bank 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). Gross recklessness by a debtor is enough to prove intent to deceive. In re Barnacle, 44 B.R. 50, 55 (Bankr. D. Minn. 1984).

In the case at bar, Defendant's financial statement was materially false in that large, significant debts were omitted from the statement. Defendant knew the financial statement was false when she presented it to Bank for the advance. She overstated her income and understated her liabilities. Thus, Bank has proven the first two elements of §523(a) (2) (B).

Concerning the third element, reasonable reliance, Bank followed its usual business practices in extending the credit. Defendant had an existing loan with Bank and her payment history had been good. Thus, Bank's reliance upon the financial statement was reasonable under the circumstances.

Concerning the fourth element, intent to deceive, Defendant is relatively sophisticated in financial matters as she had experience in the area of finance and had taken advanced schooling to increase her knowledge in the field of accounting. Defendant was undergoing financial stress at the time, because of her marital status, and used the false financial statement to obtain the advance in order to relieve the financial strain. Thus, Bank has proven the fourth and final element, making the debt non-dischargeable.

Given that Bank has met its burden of proof under §523(a) (2) (B), the only remaining issue is to determine how much of Defendant's debt owed to Bank is non-dischargeable. Bank argues the entire debt is non-dischargeable while Defendant argues only the new money advanced is non-dischargeable.

The courts are split on whether the entire debt or only the new money advanced should be declared non-dischargeable. Some courts have held the maximum amount which can be held non-dischargeable under §523(a)(2)(B) in a refinancing arrangement is the amount of new money advanced. In re Wright, 52 B.R. 27, 29 (Bankr. W.D. Pa. 1985); see Barnacle, 44 B.R. at 55. Other courts, however, have held that where a creditor has reasonably relied upon a false financial statement in refinancing an existing loan, the entire debt is non-dischargeable. In re Greenidge, 75 B.R. 245, 247 (Bankr. M.D. Ga. 1987); see In re Tomei, 24 B.R. 204, 206

(W.D. N.Y. 1982). Upon review, the Court adopts the Wright line of reasoning and holds that under §523(a)(2)(B), the maximum amount which can be held non-dischargeable in a refinancing arrangement is the amount of the new money advanced.

In the case at bar, Defendant was not in default on her loan at the time of the advance on July 15, 1987. Bank relied to its detriment on the false financial statement only to the extent of new money advanced. Consequently, only the advance of $2,852.73 of new money is non-dischargeable.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Bank has proven by clear and convincing evidence that: 1) Defendant's statement was materially false; 2) at the time Defendant prepared and presented the financial statement to Bank, she knew it was false; 3) Defendant made the false representations with the intention and purpose of deceiving Bank; 4) Bank reasonably relied on Defendant's false representations; 5) Defendant obtained an advance of $2,852.73 of new money as a result of said misrepresentation; and 6) Bank suffered a loss of $2,852.73, plus interest, as a proximate result of said misrepresentations.

IT IS ACCORDINGLY ORDERED that the obligation of Defendant, Deirdre Lee Pavelka, to the Plaintiff, Mills County State Bank, in the amount of $2,852.73, plus interest, is non-dischargeable under §523(a)(2)(B). An appropriate judgment shall be entered.

Dated this 9th day of December, 1988.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE