

Dischargeability
Section 523(a)(2)(A)
Debt for business loan

Gelco Const. Co. v. Plum, Adversary No. 08-6041-fra
Troy L. Plum, Case No. 07-63624-fra7

3/20/2009 FRA

Unpublished

Debtor/Defendant obtained a loan in the amount of \$350,000 from Plaintiff, a construction company he had done some business with in the past, in order to purchase a business. Debtor neglected to inform Plaintiff that \$50,000 of the loan amount would be used to pay off personal credit cards, or that the purchase price of the business was actually \$700,000. The \$300,000 from Plaintiff's loan was actually the down payment for the purchase, with the remaining \$400,000 secured by the business. Debtor testified that he thought that by paying off the credit cards, he would improve his credit score sufficiently to qualify for an SBA loan to complete the purchase of the business and repay the amount borrowed from Plaintiff.

As it turned out, the SBA loan did not occur and, due to the tightening economy, revenues from the newly-purchased business declined sharply. Ultimately, the Debtor was forced to file for bankruptcy.

Plaintiff filed an adversary proceeding, seeking a money judgment for the amount due of just under \$300,000 and a declaration that the judgment is nondischargeable under § 523(a)(2)(A).

The Court found the debt to be nondischargeable, ruling that it was obtained under "false pretenses," a course of conduct, as contrasted with an explicit representation, which is intended to mislead. The Court held that Debtor deliberately failed to disclose material facts in order to obtain the loan and that Plaintiff's reliance, while unfortunate, was justifiable under the circumstances.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	Bankruptcy Case
)	No. 07-63624-fra7
TROY L. PLUM)	
)	
_____ Debtor.)	
GELCO CONSTRUCTION CO.,)	Adversary Proceeding
)	No. 08-6041-fra
)	
Plaintiff,)	
vs.)	
TROY L. PLUM,)	MEMORANDUM OPINION
)	
_____ Defendant.)	

Defendant/Debtor owes Plaintiff Gelco Construction approximately \$300,000, the remaining balance on an unsecured loan. Gelco seeks a judgment for the balance due and alleges in its complaint that the loan was procured through Defendant's fraud, and that the balance due should be excepted from discharge under Code § 523(a)(2)(A). After considering the evidence presented at trial, the court finds for the Plaintiff.

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1 I. BACKGROUND

2 Defendant had an opportunity to purchase a business, PacWest
3 Engineering ("PacWest"), for \$700,000. The terms of the proposed sale
4 required that he put \$300,000 down, and pay the balance, with interest,
5 in one year.

6 Lacking the money to pay the down payment, Defendant approached
7 Plaintiff and asked for a \$350,000 loan. Plaintiff's manager testified
8 that the Defendant implied that the \$350,000 was the total purchase
9 price, and that Defendant had arranged for a loan to repay Gelco after
10 the sale of the business closed. Defendant's explanation to Gelco was
11 that he had been told by a loan broker that the loan would be easier to
12 obtain if Defendant already owned the business. Defendant summarized the
13 discussion in an e-mail to Plaintiff's manager on May 8, 2007:

14 Thank you very much for going over my proposal for
15 buying PWE Oregon. After our phone call followed up
16 with OSU Federal and am very confident that I will be
17 able to get an SBA loan within 3 months of buying PWE.
18 If I got a \$350,000 loan from Gelco I propose paying
19 it back as follows. Initial loan based on 48 months
20 at 15% for a monthly payment of \$9,740.76. Upon
21 closing the purchase deal, I would immediately begin
22 the application process for an SBA loan. I[f]
23 everything goes [as] predicted I would pay Gelco three
24 monthly payments after which time my SBA loan would be
25 approved an [sic] I would pay the loan off in full in
26 the third month. With the full payoff could pay an
additional sum for your time and effort.

To help you feel more secure about the loan here is
some overall financial information about PWE Oregon.

Gross yearly revenue = \$1,000,000.
Gross year profit = \$350,000.

I appreciate your consideration in this matter and
look forward to discussing it with you further.

On the strength of these discussions Plaintiff lent Defendant

1 the sum of \$350,000. The loan was funded by a check dated March 23,
2 2007. No financial statements were requested or offered, and Gelco did
3 not inquire further into the nature of the business being purchased or
4 the terms of the sale. There was no further inquiry into Defendant's
5 financial condition. It should be noted that, while the parties had done
6 some business together in the past, no formal business relationship
7 existed between them at the time of the loan.

8 Defendant's purchase of the business closed on June 15, 2007.
9 Three hundred thousand dollars of the money loaned to him was paid to the
10 seller. The remaining \$50,000 was used to pay credit card debt
11 previously owed by the Defendant. Defendant did not disclose to the
12 Plaintiff this intended use of the loan proceeds prior to the time the
13 loan was approved. Indeed, it is clear that the Plaintiff believed that
14 the entire \$350,000 would be used to purchase the business. Plaintiff's
15 representative testified that, had Plaintiff known of the need to pay
16 down unrelated debt, or that the total price was twice what they had
17 understood it to be, the loan would not have been made.

18 Defendant reasons that he needed to spend the \$50,000 to reduce
19 his credit card debt in order to improve his credit rating to the point
20 where he could qualify for the SBA loan that would fund his repayment of
21 the down payment, as well as the balance due on the purchase.

22 After the purchase of the business closed, its prospects, and
23 the Defendant's, diminished rapidly. Due to a tightening economy and
24 cutbacks in the construction business, the newly purchased business's
25 revenues declined sharply. Moreover, despite his payoff of his credit
26 card debt, Defendant's credit rating never improved to the point where he

1 could qualify for the needed small business loan. Ultimately he was
2 forced to file for bankruptcy relief.

3 Before filing his petition for relief, Defendant had managed to
4 pay roughly \$50,000 to Gelco. According to Plaintiff's proof of claim,
5 there remains a balance due of \$298,414.00.

7 II. DISCUSSION

8 Code Sec. 523(a) excepts from discharge a debt incurred

9 (2) for money, property or services, or an extension,
10 renewal, or refinancing of credit, to the extent
obtained by-

11 (A) false pretenses, a false
12 representation, or actual
13 fraud, other than a
statement respecting the
14 debtors's or an insider's
financial condition.

15 In order to prove fraud under § 523(a)(2)(A), a creditor must
16 prove by a preponderance of the evidence the following five elements: (1)
17 the debtor made a material representation, (2) with knowledge of its
18 falsity, (3) with the intent to deceive, (4) on which the creditor
19 justifiably relied, and (5) due to which the creditor sustained loss or
20 damage. In re Kirsh, 973 F.2d 1454, 1457 (9th Cir. 1992).

21 Under the Code, "false pretenses" contemplates circumstances in
22 which a course of conduct - as contrasted with an explicit representation
23 - is intended to mislead. It includes an implied misrepresentation or
24 conduct intended to create or foster a false impression. In re Cole, 164
25 B.R. 951 (Bankr. N.D. Ohio 1993). Moreover, fraud or false pretenses may
26 be discerned where the debtor has failed to disclose facts material to

1 the lender in order to induce the lender to grant credit. In re Roberti,
2 183 B.R. 991 (Bankr. D. Conn. 1995) (Deliberate nondisclosure of a
3 material fact may amount to a "false pretense" under § 523(a)(2)(A)).

4 Defendant told Plaintiff that he needed \$350,000 to purchase
5 the business he was interested in. He did not disclose that:
6 (1) the funds being borrowed would only cover the down payment, (2) he
7 would owe an additional \$400,000, secured by the business, and (3) that
8 \$50,000 of the funds would be used to pay unrelated debts. He stated
9 that he required \$350,000 to buy the business, when in fact he needed
10 \$50,000 to clear up his shaky financial circumstances and \$300,000 to
11 obtain possession of the business, for which he would continue to owe an
12 additional \$400,000. While what Defendant represented may have been true
13 in the strictest sense, it was meant to conceal from the Plaintiff good
14 reasons not to part with its money.

15 Particularly troubling is Defendants' failure to disclose his
16 intention to use \$50,000 of the money borrowed to pay existing
17 indebtedness. Defendant reasoned that paying these debts, being
18 necessary to enhance his credit and thus facilitate a subsequent loan,
19 was part of the cost of purchasing the business. This is too much of a
20 stretch: buying a business, or taking out a loan, and paying down old
21 debt to enable a purchase are separate matters, particularly insofar as
22 the Defendant benefitted from the elimination of the old debt whether he
23 bought the business or not. He was obligated to advise Plaintiff of his
24 intentions before he induced it to lend the money.

25 Plaintiff's witness testified that, had Plaintiff known of the
26 nature of the purchase, or of Defendant's need to pay \$50,000 in old

1 debt, it would not have lent him the money. No doubt Plaintiff (and
2 Defendant, for that matter) would have been spared a lot of grief had it
3 enquired into the details of the purchase, or of Defendant's financial
4 strength. However, a creditor's reliance on a prospective borrower need
5 only be justifiable, not reasonable. Field. v. Mans, 516 U.S. 59(1995).
6 Plaintiff's negligence in failing to discover the correct circumstances
7 of the transaction is not a defense. In re Apte, 96 F.3d 1319,1322 (9th
8 Cir. 1996); In re Kirsh, 953 F.2d 1454 (9th Cir. 1992). Defendant was
9 known to Plaintiff through their good working relationship prior to the
10 loan, and Plaintiff had no reason to doubt him. Its reliance, while
11 unfortunate, was justifiable.

12 III. CONCLUSION

13 Plaintiff has a claim against Defendant for \$298,414. The
14 claim was incurred as a result of Defendant's false pretenses, and for
15 that reason cannot be discharged. A money judgment should be entered for
16 Plaintiff in the amount of the claim with a determination that the claim
17 is excepted from discharge.

18 The foregoing constitutes the court's findings of fact and
19 conclusions of law. Counsel for the Plaintiff shall submit a form of
20 judgment consistent with this opinion.

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24 FRANK R. ALLEY, III
25 Bankruptcy Judge
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