United States Bankruptcy Court
District of New Mexico

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Case Number: **99-01068**
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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
SEYFRED LEO TOLEDO,
Debtor. No. 7-99-10382 SA

SANDIA LABORATORY FCU,
Plaintiff,
v. Adv. No. 99-1068 S

SEYFRED LEO TOLEDO,
Defendant.

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

This matter came before the Court for trial on the merits of Sandia Laboratory Federal Credit Union's ("SLFCU") complaint objecting to discharge of debtor's debt pursuant to 11 U.S.C. § 523(a)(2)(B). This is a core proceeding under 11 U.S.C. § 157(b)(2)(I).

FACTS

1. On or about July 25, 1996, debtor opened a line of credit with SLFCU.
2. In early November 1998, the balance due under the line of credit was approximately $ 3,500.
3. Sometime in early November 1998, debtor deposited a check into a checking account he maintained with SLFCU and received immediate credit on it. The check was eventually returned because debtor had failed to get the signature of a joint payee (Rich Ford, an automobile dealership) before depositing the check.

4. As of November 24, 1998, debtor was overdrawn approximately $1,100 in his checking account.

5. During the month of November SLFCU's agents had several contacts with debtor about clearing up the overdraft.

6. On November 24, 1998, debtor partially filled out a "Loanliner Application and Credit Agreement" with SLFCU as a long term workout for the combined overdraft and line of credit debts. The information completed by debtor included: Section 1, where the stated purpose of the loan was "pay my checking account"; Section 2 "Applicant information" section (consisting of items such as name, date of birth, address); Section 10, "Signatures," which debtor signed and dated; and Section 11, "Credit Insurance Application," where debtor declined insurance and signed. Sections 3, 4, 5, and 6 (employment information, income information, references, and assets) were left blank. Section 7, Debts, is a listing of ten creditors with no information on the balances owed, monthly payment, or past due status. The handwriting of section 7 is obviously different from the debtor's. Both SFLCU's witness and Debtor testified that this portion was completed by the loan officer after reviewing debtor's credit bureau report. In section 10, above debtor's signature, the agreement states:

> You have read the LOANLINER Agreement and Addendum and by signing below, you agree to be bound by the terms of the agreement. You also promise that everything you have stated in this application is correct to the best of your knowledge and that the above information is a complete listing of all your debts and obligations.

7. SLFCU's witness testified that if a customer had a previous loan with SLFCU the Loanliner Application only needs to include items that have changed since the prior loan.

8. The loan officer reviewed a credit bureau report and the Loanliner application with debtor. Debtor testified that he thought everything about his credit was on the credit bureau report. He also testified that he thought the only debts that SLFCU was interested in were credit cards and loans.

9. The list of creditors on the Loanliner Agreement excluded several creditors owed relatively small amounts, but also excluded a debt to debtor's ex-wife in the amount of $30,000 pursuant to a divorce decree dated June 1998. This debt was to be paid $10,000 on March 1, 1999, 2000, and 2001. Debtor testified that he did not understand this was a debt, because it was from the divorce, and was not yet "due" and therefore not a "bill." As to the other smaller creditors, he stated that he did not understand they were debts either because he was going to pay them or they were not yet "due."

10. Omission of the $30,000 debt made the Loanliner Application materially false.

11. Even with the omitted debts listed above, the loan was not automatically approved. The loan had to be taken before the review committee, which ultimately approved the application.

12. An SLFCU employee testified that had the other debts been listed, the debt to income ratio would have been much higher and the loan committee would not have approved the application.

13. SLFCU reasonably relied on the Loanliner Application in extending credit on November 24, 1998 in the amount of $4,592.83. The proceeds were used to clear the overdraft and pay off the line of credit.

14. The debtor testified that when the November 1988 check was returned he asked SLFCU for a loan. He testified that the entire process took about thirty minutes; he filled out portions of the application and the loan officer completed portions. The loan officer then went over the credit bureau report with him. He believed that the credit bureau report listed all of his debts, and testified that the loan officer did not ask him about other debts. He testified credibly that he did not intentionally hide anything, and he believed SLFCU already knew everything about him and his financial status. It appeared to the Court that debtor was

financially unsophisticated (albeit not generally unsophisticated and certainly not incompetent), and even seemed to have relied on SLFCU to document his application for an extension of credit that he believed had already in fact been extended. The Court believes debtor was negligent, but that his behavior did not amount to recklessness, intentional deceit or concealment, or fraud.

CONCLUSIONS OF LAW

1. To prevail on a claim under § 523(a)(2)(B), the creditor must show the use of a statement in writing a) that is materially false, b) respecting the debtor's financial condition, c) on which the creditor reasonably relied, and d) that the debtor caused to be made or published with the intent to deceive. 11 U.S.C. § 523(a)(2)(B). The creditor must prove each element by a preponderance of the evidence. Grogan v. Garner, 489 U.S. 279, 291, 111 S.Ct. 654, 661 (1991).

2. A majority of courts have concluded that a debtor who has caused a creditor to grant a delay in receiving or collecting payment that is due has received an extension of credit within the meaning of § 523(a)(2). National City Bank v. Plechaty (In re Plechaty), 213 B.R. 119, 124-25 (6th Cir. B.A.P. 1997)(citations omitted).

3. SLFCU made an extension of credit to debtor on November 24, 1998. "An extension, within the meaning of § 523(a)(2), is 'an indulgence by a creditor giving his debtor further time to pay an existing debt.'" John Deere Company v. Gerlach (In re Gerlach), 897 F.2d 1048, 1050 (10th Cir. 1990)(citations omitted.) SLFCU could have denied the application on that date and taken steps to collect. Instead, it rewrote the line of credit and overdraft into a new signature loan payable over a two-year period. Accord Plechaty, 213 B.R. at 126 (Creditor's decision to delay making demand is an extension of credit under §523(a)(2).)

4. Under the law of the Tenth Circuit, new debts procured through fraud are excepted from discharge, as well as old debts which are extended, renewed, or refinanced through fraud. Gerlach, 897 F.2d at 1050 (discussing 11 U.S.C. § 523(a)(2)(A)) and 1051 n.2. Compare Norwest Financial New Mexico Inc. v. Ojeda (In re Ojeda), 51 B.R. 91, 92 (Bankr. D. N.M. 1985)(pre-Gerlach case applying "fresh cash rule").

5. The "Loanliner Application and Credit Agreement" was a statement in writing respecting the debtor's financial condition.

6. The "Loanliner Application and Credit Agreement" was materially false in that it omitted significant liabilities.

7. Under all the circumstances, the Court finds that SLFCU both actually and reasonably relied on the writings. SLFCU's agent testified that the documents were compared to credit bureau reports and that the officer discussed the information in the credit bureau report and the application with debtor. Also, approval of the loan was not automatic, all documents were further reviewed by the loan committee. There was credible testimony that had there been accurate disclosure, the loan would not have been approved.[1] See Piper Acceptance Corporation v. Cantrell (In re Cantrell), Adv. No. 85-0145M (Bankr. D. N.M. Sept. 30, 1986)(discussing reliance and reasonable reliance).

8. As is typically the case in this type of action, intent is very difficult to prove and the evidence is circumstantial. In this case, SLFCU gave circumstantial evidence of debtor's intent to deceive: the magnitude and materiality of the omission on the financial statement, see Marx v. Reeds (In

[1] Nothing in this opinion is to be taken as a criticism of the credit union's procedure employed in these circumstances. The expedited procedure for obtaining information and rendering a credit decision presumably benefits both members and the credit union itself. Nor is this opinion to be taken as a criticism of the credit union for accommodating the needs of one of its members in a straitened financial condition. The credit union witness testified that a 45% debt ratio was the limit above which a committee decision was required to approve the credit. The debt ratio here (without the $30,0000.00) was 68%; however, the witness also testified that she had seen SFLCU members work out of situations with a debt ratio this high.

re Reeds), 145 B.R. 703, 707 (Bankr. N.D. Ok. 1992), the previous deposit of the check without a cosignature and resulting overdraft, debtor's expressed urgency to obtain renewed access to his checking account and automatic teller machine, his bleak financial future. Debtor, however, gave equally credible testimony that 1) he approached SLFCU openly, believing they already knew about and understood his plight, and 2) he honestly believed the financial statement and accompanying credit bureau report, neither of which showed the $30,000.00 obligation to his former spouse, reflected a complete and true picture of his situation. The Court finds debtor was negligent as well as naive about what constitutes a debt,[2] but the debtor did not exhibit any reckless disregard for the truth.

9. Section 523(d) provides as follows:

> "If a creditor requests a determination of dischargeability of a consumer debt under subsection (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 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."

[2] Debtor admitted that he now (at the time of the trial) understood that the $30,000.00 constituted a debt, but said that he learned that after the loan renewal.

Debtor timely and clearly requested an award of costs and attorney fees in its pleadings. See Hartford Police F.C.U. v. DeMaio (In re DeMaio), 158 B.R. 890, 891 (Bankr. D. Ct. 1993).

10. SLFCU made out a prima facie case on all the elements of Section 523(a)(2)(B), including intent. Debtor succeeded, however, in matching SLFCU's prima facie case on the element of intention to deceive, in the sense that the presentations on this issue were equipollent. Thus SFLCU did not establish all the elements of its case by a preponderance of the evidence. As compelling as the evidence was about the debtor's urgent need for the funds, his deposit of the check without the joint payee's endorsement, and his failure to mention the $30,000.00 owed to his ex-wife, at the end of the day the Court is not sufficiently convinced of the debtor's intent to deceive. While SFLCU could have (and probably should have) conducted a Rule 2004 examination of debtor prior to filing this adversary proceeding and thereby discovered the debtor's understanding of what a "debt" was, in these particular circumstances the Court finds that SLFCU was substantially justified in bringing this action. Given the facts as set forth above, the Court clearly cannot find that SFLCU's complaint was an abusive or frivolous filing.

Household Bank, N.A. et al. v. Sales (In re Sales), 228 F.2d 748, 753 (10th Cir. B.A.P. 1999).

THEREFORE, the Court will enter a judgment a) for defendant on the complaint, and b) denying relief under 11 U.S.C. § 523(d).

Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that, on the date file stamped above, a true and correct copy of the foregoing was either electronically transmitted, faxed, mailed, or delivered to the listed counsel and parties.

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