IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re WILLIAM LEWIS SLAUGHTER d/b/a Slaughter & Son Trucking, Debtor.	No. 02-21870 Chapter 11
KNOXVILLE TVA EMPLOYEES CREDIT UNION, Plaintiff, vs. WILLIAM L. SLAUGHTER d/b/a Slaughter & Son Trucking, Defendant.	Adv. Pro. No. 02-2061

M E M O R A N D U M

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

In this adversary proceeding, the plaintiff seeks a determination that the debt owed it by the debtor is nondischargeable pursuant to 11 U.S.C. § 523 (a)(2)(A) and (B). Presently before the court is the plaintiff's motion for summary judgment as to § 523 (a)(2)(A) based on the contention the debt was incurred through a material misrepresentation because the debtor failed to inform the plaintiff at the time of the loan that he had consulted with and retained a bankruptcy attorney for the purpose of filing a bankruptcy case. Because a genuine issue of material fact exists as to whether the debtor intended to deceive the plaintiff, the motion will be denied although partial summary judgment will be granted as to all of the other elements of nondischargeability under § 523(a)(2)(A). This is a core proceeding. *See* 28 U.S.C. § 157(b)(2)(I).

I.

It is undisputed that on March 25, 2002, the debtor, William L. Slaughter d/b/a Slaughter & Son Trucking, paid attorney Dean Greer a retainer of $7,500 for the purpose of preparing and filing on his behalf a bankruptcy petition under chapter 11. The chapter 11 case was in fact filed on June 5, 2002.

On April 1, 2002, after payment of the retainer but prior to the bankruptcy filing, the debtor contacted the plaintiff, Knoxville TVA Employees Credit Union, via telephone for the purpose of obtaining a loan to purchase an automobile. In this phone conversation, the debtor was interviewed by Debbie Conley, an employee of the plaintiff, and as a result of the conversation, the plaintiff made the debtor a loan in the amount of $22,332. The debtor did not reveal to Ms. Conley or to any other representative of the plaintiff at any time prior to the loan that he was experiencing financial difficulty and was planning to file bankruptcy. The debtor made no payments on the loan prior to the bankruptcy filing, even though the first payment had come due, and listed the plaintiff as a creditor for the full amount loaned.

On September 3, 2002, the plaintiff filed the complaint initiating this adversary proceeding. In the complaint, the plaintiff alleges that the debtor's failure to disclose his retention of a bankruptcy attorney and his intended bankruptcy filing was a material misrepresentation made with the intent to deceive, that it justifiably relied on the misrepresentation, and suffered damages as a result. Accordingly, the plaintiff requests a judgment against the debtor in the amount of $22,332 and a determination that the judgment debt is nondischargeable.

In its motion for summary judgment filed June 9, 2003, the plaintiff asserts that there is no genuine issue of material fact as to the allegations set forth in the complaint and that it is entitled to judgment as a matter of law. The motion is supported by the affidavit of Ms. Conley and two other employees of the plaintiff.

The debtor responded to the motion by filing his own personal affidavit wherein he states that he has purchased in excess of seven vehicles from the plaintiff since at least 1985 and had three other vehicles financed through the plaintiff at the time of the loan in question. The debtor explains that he contacted the plaintiff regarding this particular loan because he needed a newer, more reliable vehicle and he wanted to purchase a 2000 Nissan Maxima leased by his daughter, which she no longer needed. He also states that "I knew that by filing bankruptcy I was probably not going to be able to obtain financing to purchase a vehicle in the future and so wanted to secure a personal vehicle prior to that time."

According to the debtor, his loan was approved over the phone and he was advised that he only needed to come by and sign the papers. "I remember supplying little information except for information concerning the vehicle I was purchasing and to whom the loan proceeds would be paid," the debtor states. Although he admits that he "did not advise the individual with whom [he] spoke at the Credit Union that [he] had retained Mr. Greer to file a chapter 11 bankruptcy or that [he] was considering filing a chapter 11 bankruptcy," he explains that he "was not asked any question that would have required disclosure of that fact to be truthful."

The debtor states that his purpose in retaining Mr. Greer and filing a chapter 11 was to reorganize his trucking business. He states that he "had no intention to deceive the Credit Union" and denies that he made "any misrepresentation or utter[ed] any falsehood to the Credit Union in connection with this transaction." The debtor attributes this adversary proceeding to the plaintiff's failure to timely record its lien on the automobile purchased by the debtor. The debtor stated that he "had not expected nor anticipated" that the plaintiff's lien would be avoidable and that it had been his intention to pay the plaintiff. Based on all of the foregoing, the debtor argues that material issues of genuine fact exist as to whether he made a misrepresentation and his intentions, thus precluding summary judgment.

II.

Fed. R. Civ. P. 56, as incorporated by Fed. R. Bankr. P. 7056, mandates the entry of summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." In ruling on a motion for summary judgment, the inference to be drawn from the underlying facts contained in the record must be viewed in a light most favorable to the party opposing the motion. *See National Enters., Inc. v. Smith*, 114 F.3d 561, 563 (6th Cir. 1997).

III.

Pursuant to 11 U.S.C. § 523(a)(2)(A), a discharge will not be issued for any money debt to the extent it was obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." In order to prevail under this provision, the plaintiff must prove: "(1) the debtor obtained money [or services, or an extension, renewal, or refinancing of credit] through a material misrepresentation that, at the time, the debtor knew was false or made with gross recklessness as to its truth; (2) the debtor intended to deceive the creditor; (3) the creditor justifiably relied on the false representation; and (4) its reliance was the proximate cause of loss." *Rembert v. AT&T Universal Card Servs., Inc. (In re Rembert)*, 141 F.3d 277, 280-

81 (6th Cir. 1998). The debtor's intent to defraud the creditor is gauged by a subjective standard, and the totality of the circumstances must be examined. *Id*. at 281-82.

Following the test laid out by the Sixth Circuit Court of Appeals in *Rembert*, the first element which must be established is that the debtor received money through a material misrepresentation that, at the time, the debtor knew was false or made with gross recklessness to the truth. The plaintiff claims that the debtor's silence as to the planned bankruptcy filing constituted a material misrepresentation and that had the plaintiff known of the contemplated bankruptcy, it never would have approved the loan. On the other hand, the debtor claims he never actively gave any oral or written misrepresentation about whether he intended to file for bankruptcy. The debtor maintains he was not asked any bankruptcy related questions, and that is why he did not divulge any bankruptcy related information to the plaintiff.

In interpreting 11 U.S.C. § 523 (a)(2)(A), "bankruptcy courts have overwhelmingly held that a debtor's silence regarding [a] material fact can constitute a false representation actionable" under that section. *Wolstein v. Docteroff (In re Docteroff)*, 133 F.3d 210, 216 (3rd Cir. 1997)(quoting *Caspers v. Van Horne (In re Van Horne)*, 823 F.2d

1285, 1288 (8th Cir. 1987)[*]). *See also Melhorn v. Copeland (In re Copeland)*, 291 B.R. 740, 760 (Bankr. E.D. Tenn. 2003), and cases cited therein. "Generally, a material misrepresentation can be defined as 'substantial inaccuracies of the type which would generally affect a lender's or guarantor's decision.'" *In re Copeland*, 291 B.R. at 761 (quoting *Candland v. Ins. Co. of N. Am. (In re Candland)*, 90 F.3d 1466, 1470 (9th Cir. 1996)).

Materiality is easily satisfied in this case. Both Ms. Conley and Kim Kenyon, a senior loan officer for the plaintiff, state in their affidavits that they "would not have approved [the debtor's] loan request had [they] known that he consulted an attorney about filing for bankruptcy or that he had paid an attorney for that purpose." The debtor's own affidavit establishes that he is aware that bankruptcy is a material factor in obtaining credit since he states that "I knew that by filing bankruptcy I was probably not going to be able to obtain financing to purchase a vehicle in the future ...."

The debtor's assertion that the plaintiff failed to ask him any questions which would have required disclosure of his

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[*]Although one of the holdings in the *Van Horne* decision (unrelated to this case) was overruled by *Thul v. Ophaug (In re Ophaug)*, 827 F.2d 340 (8th Cir. 1987), as noted in *Goodnow v. Adelman (In re Adelman)*, 90 B.R. 1012, 1019 n.2 (Bankr. S.D. 1988), the remainder of the opinion remains good law.

contemplated bankruptcy filing provides no defense. While "liability for nondisclosure can arise only in the cases where the person being held responsible had a duty to disclose the facts at issue,*" Macon County Livestock Market, Inc. v. Kentucky State Bank, Inc.*, 724 S.W.2d 343, 349 (Tenn. App. 1986); "[a] borrower has the duty to divulge all material facts to the lender." *In re Van Horne*, 823 F.2d at 1288 (citing *Nat'l Bank of N. Am. v. Newmark (Matter of Newmark)*, 20 B.R. 842, 855 (Bankr. E.D.N.Y. 1982)). "While it is certainly not practicable to require the debtor to 'bare his soul' before the creditor, the creditor has the right to know those facts touching upon the essence of the transaction." *Id. See also Apte v. Japra (In re Apte)*, 96 F.3d 1319, 1324 (9th Cir. 1996)("[A] party to a business transaction has a duty to disclose when the other party is ignorant of material facts which he does not have an opportunity to discover."). Because an anticipated bankruptcy filing is a material fact which the debtor had a duty to disclose and because the debtor kept silent about this material fact during the loan approval process, the plaintiff has established the first prong of nondischargeability under § 523(a)(2)(A) as identified in *Rembert*.

The next requirement is that the debtor intended to deceive the plaintiff. "Whether a debtor possessed an intent to defraud a creditor within the scope of § 523(a)(2)(A) is measured by a subjective standard," *In re Rembert*, 141 F.3d at 281; with the proper inquiry being whether "the debtor subjectively intended to repay the debt." *Id.* "[A] debtor's intention—or lack thereof—must be ascertained by the totality of the circumstances." *Id*. at 282.

In support of its assertion that there is no genuine issue of material fact regarding the debtor's intent to deceive, the plaintiff cites the temporal proximity between the retention of Mr. Greer and the loan (one week), his admission that one of the reasons he was borrowing money to buy a car was because he knew that when he filed bankruptcy he was "probably not going to be able to obtain financing to purchase a vehicle in the future," and his failure to make any payments on the loan prior to the commencement of his bankruptcy case. The plaintiff argues that these "circumstances suggest that Debtor knew [the plaintiff] would not approve the Loan if it had notice that Debtor intended to file for bankruptcy protection."

The plaintiff also notes that the Sixth Circuit Court of Appeals has held that the "intent to deceive" requirement may be satisfied by evidence of gross recklessness. *See Knoxville Teachers Credit Union v. Parkey*, 790 F.2d 490, 492 (6th Cir. 1986) (interpreting 11 U.S.C. § 523(a)(2)(B)). In this regard, the plaintiff cites *Bank One, Lexington, N.A. v. Woolum (In re Woolum)*, 979 F.2d 71, 73 (6th Cir. 1992), wherein the debtor in that case had failed to list on his financial statements two guaranties he signed on behalf of his brother-in-law's corporation even though he had submitted the statement to his lender less than one month after having been sued on one of the guaranties. Notwithstanding the debtor's testimony that he had forgotten one of the guaranties and that he had relied on assurances from his brother-in-law that the lawsuit was a mistake, the bankruptcy court concluded that he had acted at least with gross recklessness in failing to list these obligations on his financial statement. *Id.* at 73.

Although there are some parallels between the present case and *Woolum*, it must be noted that the ruling in that case was based on testimony presented at an evidentiary hearing. While the issue is a close one, the court concludes that in light of the Sixth Circuit Court of Appeals' directive that intent is a subjective determination which requires a consideration of the totality of the circumstances and the debtor's statement that he always intended to pay the plaintiff notwithstanding the bankruptcy filing, a genuine issue of fact exists as to the debtor's intent. To hold otherwise would be tantamount to ruling that any individual who fails to give notice of his intended bankruptcy to a prospective lender has acted with gross recklessness per se, a conclusion that this court refuses to reach.

The third *Rembert* element for nondischargeability under § 523(a)(2)(A) is whether the plaintiff justifiably relied on the debtor's false representation. "A logical prerequisite for justifiable reliance is a showing by the creditor that it 'actually relied' and that its reliance was then justifiable." *In re Copeland*, 291 B.R. at 767 (citing *Kinsler v. Pauley (Matter of Pauley)*, 205 B.R. 501, 506-07 (Bankr. W.D. Mich. 1997), and *AT&T Universal Card Servs. v. Alvi (In re Alvi)*, 191 B.R. 724, 730-31 (Bankr. N.D. Ill. 1996)). In *Field v. Mans*, 516 U.S. 59, 74-75 (1995), the United States Supreme Court declared that justifiable reliance "is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases." *Id.* at 71 (quoting RESTATEMENT (SECOND) OF TORTS § 545A cmt. b (1976)). "[A] person is justified in relying on a representation of fact 'although he might have ascertained the falsity of the representation had he made an investigation.'" *Id*. at 69 (quoting RESTATEMENT (SECOND) OF TORTS § 540 (1976)). "[I]t is only where, under the circumstances, the facts should be apparent to one of his knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived, that he is required to make an investigation of his own." *Id*. at 71 (quoting W. PROSSER, LAW OF TORTS § 108 (4th ed. 1971)). *See also Redmond v. Finch (In re Finch)*, 289 B.R. 638, 644 n.4 (Bankr. S.D. Ohio 2003)(justifiable reliance is a more subjective standard than reasonable reliance).

As argued by the plaintiff, actual reliance is established by the affidavits of its employees wherein they state that the loan to the debtor would not have been made if they had known of the intended bankruptcy filing. The debtor does not dispute this fact. As to justifiable reliance, also unrefuted by the debtor, Ms. Conley states that in approving the loan to the debtor, "she relied, among other things, upon the information from the telephone interview and [the debtor's] prior excellent loan history." Similarly, the debtor notes that he "had a long history of loans with [the plaintiff] and had always paid promptly and in full." "Section 523(a)(2)(A) does not ordinarily require lenders to assume that ... borrowers who have been credible in the past will not continue to be credible." *Ledford v. BancBoston Mortgage Corp. (In re Ledford)*, 970 F.2d

1556, 1560 (6th Cir. 1992). "[T]he [reliance] requirement merely prevents creditors from looking the other way in the face of facts that ought to raise suspicions." *Id*. In light of the debtor's previous excellent credit with the plaintiff and the absence of any facts or red flags which should have served as a warning to the plaintiff that it was being deceived, justifiable reliance has been established.

The final element required to establish nondischargeability is that the plaintiff's reliance on the false representation was the proximate cause of its loss. "Proximate cause is established where the misrepresentation is a substantial factor in the loss and where the loss may be reasonably expected to result from reliance." *Wings & Rings, Inc. v. Hoover (In re Hoover)*, 232 B.R. 695, 700 (Bankr. S.D. Ohio 1999). Both of these components are established in this case. As noted, but for the debtor's failure to disclose his imminent bankruptcy filing, the loan would not have been made and the loss sustained. Also, it is clearly foreseeable that a lender may not get paid if its borrower files bankruptcy.

Although not directly disputing the issue of proximate cause, the debtor cites in his affidavit the plaintiff's failure to perfect its lien and intimates that this is the cause of plaintiff's loss. "[H]owever, [in determining proximate cause] courts must refrain from relying on speculation to determine whether and to what extent a creditor would have suffered a loss absent fraud." *Shannon v. Russell (In re Russell)*, 203 B.R. 303, 313 (Bankr. S.D. Cal. 1996) (citing *Siriani v. Northwestern Nat'l Ins. Co. of Milwaukee (In re Sirani)*, 967 F.2d 302, 306 (9th Cir. 1992)).

In *Collins v. Palm Beach Savings & Loan (In re Collins)*, 946 F.2d 815 (11th Cir. 1991), a case cited by the plaintiff, the court rejected the debtor's argument that the creditor's failure to perfect its security interest, rather than the debtor's false financial statements, was the proximate cause of the creditor's loss. As stated by the court:

> Although [the creditor] could have prevented its own injury by perfecting its interest in [the debtor's] collateral property, the Bankruptcy Code does not require such diligence on the part of a creditor induced by fraudulent means in extending credit to a debtor. It is the honest debtor which Congress intended to protect through the Bankruptcy Code, especially when discharging a bankrupt's debts.

Id. at 816. *See also In re Oh*, 278 B.R. 844, 857 (Bankr. C.D. Cal. 2002)("The Debtor cannot escape liability under section 523(a)(2)(A) or (B) by demonstrating that [the creditor] might have done something to prevent its loss. There is no 'last clear chance' doctrine in the context of section 523."). The fact that the plaintiff lost one means of collecting its debt does not obviate the fact that but for the debtor’s silence as to his planned bankruptcy, the loan would not have been made. Accordingly, the causation requirement of § 523(a)(2)(A) has been satisfied.

IV.

In summary, there are no genuine issues of material fact and the plaintiff is entitled to judgment as a matter of law as to the assertions that the debtor obtained money through a material misrepresentation known by the debtor to be false, the plaintiff justifiably relied on that misrepresentation, and its reliance was the proximate cause of its loss. The only issue remaining for trial is whether the debtor intended to deceive the plaintiff. An order will be entered in accordance with this memorandum opinion granting the plaintiff partial summary judgment with respect to all elements of nondischargeability under § 523(a)(2)(A) except intent.

FILED: July 30, 2003

BY THE COURT

MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE