

**United States Bankruptcy Court
Northern District of Illinois
Eastern Division**

Transmittal Sheet for Opinions

Will this opinion be published? No

Bankruptcy Caption: Herbert Beigel

Bankruptcy No. 97 B 14014

Adversary Caption: Interserv, L.P., v. Herbert Beigel

Adversary No. 97 A 01423

Date of Issuance: November 6, 2000

Judge: Susan Pierson Sonderby

Appearance of Counsel:

Attorney for Movant or Plaintiff: Frank J. Kokoszka

Attorney for Respondent or Defendant: Herbert Beigel

Trustee or Other Attorneys: U.S. Trustee

**NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:)	Chapter 7 Case
)	
HERBERT BEIGEL,)	Case No. 97 B 14014
)	
Debtor,)	
_____)	Honorable Susan Pierson Sonderby
)	
INTERSERVE, L.P.,)	Adv. No. 97 A 01423
)	
Plaintiff.)	
)	
v.)	
)	
HERBERT BEIGEL,)	
)	
Defendant.)	

CERTIFICATE OF MAILING

I, Georgia Demeo certify that I caused to be mailed copies of the attached **FINDINGS OF FACT AND CONCLUSIONS OF LAW** and **ORDER** to the persons listed on the attached service list on November 7, 2000.

Secretary to Chief Judge
Susan Pierson Sonderby

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**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

IN RE:)	Chapter 7
)	
HERBERT BEIGEL,)	No. 97 B 14014
)	
Debtor.)	Honorable Susan Pierson Sonderby
_____)	
)	
INTERSERV, L.P.,)	
)	Adv. No. 97 A 01423
Plaintiff,)	
)	
v.)	
)	
HERBERT BEIGEL,)	
)	
Defendant.)	
_____)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Plaintiff InterServ, L.P., (“Plaintiff”) seeks a determination that a debt owed it by Debtor Herbert Beigel (the “Debtor”) is nondischargeable under § 523(a)(2)(B) of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (the “Code”). The Court held a trial on June 27, 2000, and it now enters its findings of fact and conclusions of law.

The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334 and Internal Operating Procedure 15(a) of the United States District Court for the Northern District of Illinois. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

FINDINGS OF FACT

1. The Debtor was the senior partner of the law firm of Beigel, Schy, Lasky, Rifkind, Fertick & Gelber (The “Firm”), a professional corporation. During the time period relevant to this dispute, the Firm had offices in New York City, Chicago, and Los Angeles.
2. In July 1996, Plaintiff and the Firm entered into negotiations for a commercial lease of office space located at 9952 Santa Monica Boulevard, Suite 101 of the Ground Floor, Beverly Hills, California. The individuals conducting those negotiations were Paul Resnick (“Resnick”), Plaintiff’s senior partner, and Michael White (“White”), the Firm’s partner in Los Angeles.
3. Prior to entering into the lease agreement, Resnick requested the Debtor’s personal guarantee of the proposed lease obligations and a current statement of the Debtor’s financial affairs. Resnick made that request through White.
4. On or about July 18, 1996, Plaintiff received a joint financial statement (“Financial Statement”) prepared on a form bearing the name of the IBJ Schroder Bank and Trust Company (“IBJ Schroder”). The cover sheet to the Financial Statement described the document as the “Personal Financial Statement of Herbert Beigel and Nancy Beigel as of July 12, 1995.”
5. The income statement within the Financial Statement reported actual income of \$6,100,000.00 for 1994 and anticipated income of \$4,100,000.00 for 1995, for a total of more than ten million dollars. However, the Financial Statement did not specify whether the Debtor or his wife had earned or would earn that income. Within that section of the document dealing with personal information, it was stated that Debtor was a lawyer and that his wife was a student.
6. The balance sheet within the Financial Statement reported marketable securities of \$820,000.00, limited partnership interests valued at \$194,500.00, and other personal property of \$1,900,000.00.

Cash on hand and in banks was reported to be \$686,062.00. Several bank statements attached to the Financial Statement indicated that certain bank accounts and marketable securities were held in joint tenancy, but the statement did not disclose whether one or both spouses owned the other items of personal property listed on the balance sheet.

7. The Financial Statement reported ownership interests in real properties totaling \$6,025,000.00, but it did not state whether those properties were owned jointly by the Debtor and his wife, or by one spouse in his or her individual capacity. In Section D of the Supplemental Schedules in Part IV of the statement, captioned "Real Estate Owned," the amount \$6,025,000.00 was written below the heading "Current Market Value." The spaces under the heading "Cost" were left blank. Contrary to the instructions on the form, no answers were provided in spaces designated for disclosure of title ownership of particular parcels of real estate. Instead of listing real properties in section D, the preparer of the Financial Statement made the notation "See Attached Schedule."
8. Schedule E of the Financial Statement listed the various real estate holdings of the Debtor and his wife, along with estimates of each property's value under the heading "Cost/ Value." A footnote explained that the estimated value reflected either "Cost or Fair Market Value (whichever is greater)."
9. The five properties listed on Schedule E were the following: (1) real property located at 2125 Clifton, in Chicago, Illinois, reported to be valued at \$1,250,000.00 and subject to a mortgage of \$825,000.00 (the "Clifton Property"); (2) property located at 251 East 51st St- 18 A in New York, New York, valued at \$550,000.00 (the "New York Property"); (3) property located in Galena, Illinois, valued at \$50,000.00 (the "Galena Property"); (4) property located on North Seminary in Chicago, Illinois, reported to be valued at \$175,000.00 and subject to a mortgage of

\$100,000.00 (the “North Seminary Property”); and (5) property located in New Seabury, Massachusetts, valued at \$4,000,000.00, but subject to a mortgage of \$900,000.00 (the “Massachusetts Property”). Subtracting total mortgage obligations of \$1,825,000.00 from total value of \$6,025,000.00, the total reported equity in real properties was \$4,200,000.00.

10. The total value of the assets listed on the balance sheet in the Financial Statement was \$9,625,562.00. Total liabilities of \$2,375,000.00 were comprised of the \$1,825,000.00 owed on the mortgages and unsecured debt of \$550,000.00. After the offset of liabilities against assets, the Financial Statement showed a net worth of \$7,250,562.00.
11. In the supplemental schedules to the Financial Statement, in a space designated for the disclosure of potential liabilities under guarantees or from lawsuits and judgments, a \$3,500,000.00 contingent liability on a “law firm loan” was disclosed. Because the contingent liability was not reported on the balance sheet, it did not reduce reported net worth. Had the contingent liability been included in the balance sheet, liabilities would have been increased to \$5,875,000.00 and reported net worth would have been reduced to \$3,750,562.00.
12. Although those copies of the Financial Statement presented as trial exhibits are somewhat blurred, one can discern that the preprinted certification at the close of the statement contains representations that the information in the statement is true and accurate, as well as an undertaking that the signatory would notify IBJ Schroder of any unfavorable change in his or her financial condition.
13. The Financial Statement was not signed by either the Debtor or his wife. Michelle Chapuis, the Debtor’s secretary, signed the Financial Statement in the space designated for the signature of any preparer.

14. According to the Debtor, his secretary prepared the Financial Statement by copying financial information from other documents.
15. The Debtor does not recall being asked to provide a financial statement to Plaintiff in July 1996, although he is sure that he would have given permission to send the Financial Statement to Plaintiff. According to the Debtor, the most likely scenario was that his secretary advised him of Plaintiff's request for a financial statement, and that he responded by directing her to send the most recent financial statement on file. In the Debtor's opinion, the obligations for which his guarantee was sought were modest. The Debtor testified that he would have anticipated inquiries from Plaintiff if the information in the joint Financial Statement was unacceptable.
16. At trial, the Debtor testified that when personal financial information was requested by one of the banks with which the Firm did business, he would ordinarily provide a statement that had previously been prepared. New statements were not prepared unless the lender requested one. To the Debtor's recollection, joint financial statements were acceptable to lenders.
17. Questioning at trial established that the Financial Statement may have omitted certain contingent liabilities arising before it was prepared. Those contingent liabilities apparently would have arisen under guarantees of the Firm's various lease obligations. However, the Debtor denied that there were lawsuits pending against him personally as of July 1995, and Plaintiff presented no evidence that there were any such suits.
18. Between the time the Financial Statement was prepared on July 12, 1995 and the time it was submitted to Plaintiff on or about July 18, 1996, there were changes in both the assets and liabilities of the Debtor and his wife. There is no evidence of record describing particular changes, however, and the Debtor contends that none of the changes were material.

19. In his testimony at trial, the Debtor expressed his belief that due to appreciation in real estate values and investment of income earned during the preceding year, his net worth may have been higher in July 1996 than it was a year earlier. The Debtor also acknowledged that as of July 1996, there were several lawsuits pending against him.
20. The Debtor did not amend the Financial Statement to reflect any changes in his or his wife's assets or liabilities which occurred between July 1995 and July 1996.
21. At the time of the lease negotiations, the office space under consideration was unoccupied. Repairs had to be made to the premises and it was necessary to build out to specifications. In all, estimated costs were \$60,000.00 or more.
22. According to Resnick, he was concerned about the Firm's financial status because it was downsizing from a larger space. White told him that he did not have a financial statement for the Firm, and that if Plaintiff needed solid financial information, he should get that from the Debtor.
23. When questioned concerning his review of the Financial Statement, Resnick stated that he did not read it "word for word," but "flipped through it." Although the Debtor had substantial income, Resnick was more concerned with assets available to satisfy a judgment should there be a default on the lease. Here, the Financial Statement indicated that the Debtor had a lot of cash, marketable securities and real estate. Resnick testified that he was comfortable because the ratio of assets to liabilities on the balance sheet was four to one.
24. Resnick assumed that the Debtor owned half the property reported on the Financial Statement, since California is a community property state and the lease was under California law. He also assumed that the Debtor's wife would be liable on the \$3,500,000.00 contingent liability arising from the Debtor's guarantee of the Firm's indebtedness. Resnick was aware that Beigel was not

a California resident, but he did not consult with anyone to make sure that his legal assumptions were correct.

25. Resnick was not concerned about the fact that the Financial Statement was a year old, because it seemed reasonable to him that a complicated statement be prepared only once a year.
26. After receiving the Financial Statement, Plaintiff did not contact the Debtor or any representatives of the Firm with any inquiry related to the Financial Statement.
27. On or about July 19, 1996, the Debtor executed a personal guarantee for the Firm's obligations under the commercial lease agreement. Plaintiff did not request a personal guarantee from Debtor's wife.
28. On or about July 19, 1996, Plaintiff entered into a three year commercial lease with the Firm, with a base rent obligation of \$7,022.60 per month. Based on the rent provision in the lease, the Debtor calculates that the Firm's rent obligation would have been approximately \$84,000.00 per year.
29. The Firm filed a voluntary petition for relief under Chapter 11 on January 2, 1997.
30. On May 6, 1997, Debtor filed a petition for bankruptcy relief under Chapter 7 of the Bankruptcy Code. The Debtor's filing came shortly before the Firm's Chapter 11 case was converted on May 16, 1997 to a case under Chapter 7.
31. On his bankruptcy schedules, the Debtor reported ownership interests in two real properties: (1) a fifty percent interest as joint tenant in the Clifton Property, valued at \$450,000.00; and (2) ownership in fee simple of the Galena Property, valued at \$20,000.00.
32. In the schedule of secured claims that accompanied his bankruptcy petition, the Debtor reported secured debts of \$4,300,000.00. Of that amount, \$1,800,000.00 represented amounts due on

first and second mortgages of the Clifton Property. At trial, the Debtor recalled that the second mortgage secured a home equity loan, but he professed inability to remember whether the loan had been procured before July 1996.

33. Three of the properties that had been listed on the Financial Statement were not included on the Debtor's bankruptcy schedules. Explaining why the properties were not listed on his schedules, the Debtor testified at trial that his wife was the owner of the North Seminary Property, and that he did not hold title to the Massachusetts Property. The Debtor professed some inability to recall if he had ever owned an interest in the New York Property, and he stated that the property had been sold at an unspecified time before his bankruptcy filing. The Debtor expressed uncertainty as to whether the New York Property had been sold before July 1996.
34. The Debtor was also questioned at trial concerning the higher values assigned to the Clifton Property and the Galena Property on the Financial Statement. Regarding the Clifton Property, the Debtor stated that around the time of his bankruptcy filing, a real estate broker had valued the property at \$900,000.00. In 1995, however, the Debtor had been told that the Clifton Property was worth approximately \$1,250,000.00, the same amount it had cost.
35. Looking to the difference between the reported values for the Galena Property, the Debtor stated that although he had purchased the property for \$20,000.00, he personally believed it to be worth \$50,000.00 in July 1995. On his bankruptcy schedules, however, the Debtor valued the Galena Property at its cost. According to the Debtor, he had been advised to use conservative values when assembling information for his bankruptcy petition.
36. In the summary of his bankruptcy schedules, the Debtor reported unsecured debts of \$7,100,000.00 "plus unliquidated and disputed liabilities." The Debtor's statement of financial

affairs also disclosed that numerous lawsuits had been filed against the Debtor and/or the Firm.

37. Plaintiff presented no evidence at trial concerning the value in either July 1995 or July 1996 of those real properties shown on the Financial Statement. Nor was evidence presented concerning what other assets the Debtor may have owned in July 1996.
38. The parties presented no evidence concerning the nature of lawsuits pending against the Debtor in July 1996. Nor was there evidence that would quantify the amount of contingent liabilities arising out of such litigation.
39. Plaintiff has not established the amount of the Debtor's net worth as of July 1996.
40. Responding to questioning at trial, Resnick stated that he had no objective standard setting the minimum net worth required of a guarantor of a prospective tenant. Resnick indicated that he might have accepted a guarantee backed only by cash and securities with a value of \$1,700,000.00, provided there were no liabilities.
41. The Debtor also posed the hypothetical whether Resnick would have accepted the Financial Statement and the Debtor's guarantee if he knew that the Debtor had no interest in the Massachusetts Property; that he probably did not own the New York Property; that he might or might not have had an interest in the North Seminary Property; and that he had a number of contingent liabilities. Resnick's response was that if the value of the assets owned by the Debtor diminished "to the point of making [him] nervous," he would not have entered into the lease agreement with the Firm.

CONCLUSIONS OF LAW

1. Exceptions to discharge are construed strictly against a creditor and liberally in favor of the debtor. Grogan v. Garner, 498 U.S. 279, 286-87, 111 S.Ct. 654,659, (1991); Kolodziej v. Reines (In

re Reines), 142 F.3d 970, 972-73 (7th Cir. 1998), cert. denied, 525 U.S. 1068, 119 S.Ct. 797 (1999).

2. Here, Plaintiff seeks a determination of nondischargeability under § 523(a)(2)(B), which provides:

(a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual 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).

3. To prevail on its complaint under § 523(a)(2)(B), Plaintiff must demonstrate, by a preponderance of the evidence, that (1) the Debtor made a statement in writing; (2) the statement was materially false; (3) the statement concerned the Debtor's financial condition; (4) the Debtor made the statement with an intent to deceive; and (5) Plaintiff actually and reasonably relied on that statement. See, e.g., In re Morris, 223 F.3d 548, 552 (7th Cir. 2000); Selfreliance Federal Credit Union v. Harasymiw (In re Harasymiw), 895 F.2d 1170, 1172 (7th Cir.1990). Plaintiff must meet its burden of proof with regard to each and every one of the elements under § 523(a)(2)(B), or the debt will be found dischargeable. Morris, 223 F.3d at 552.

4. The Debtor contends that Plaintiff has failed to establish the following three elements under § 523(a)(2)(B): (1) that the Financial Statement was materially false, (2) that he made the statement with intent to deceive, and (3) that Plaintiff reasonably relied on the statement. As set forth in the discussion that follows, the decision here turns on Plaintiff's failure to establish material falsity.

Material Falsity

5. Generally, a financial statement is materially false if it “paints a substantially untruthful picture . . . by misrepresenting information of the type which would normally affect the decision to grant credit.” Banner Oil Co. v. Bryson (In re Bryson), 187 B.R. 939, 962 (Bankr. N.D. Ill. 1995).
6. While the inquiry into material falsity will often focus on the content of particular factual assertions made by a debtor, writings with pertinent omissions may also qualify as materially false for purposes of § 523(a)(2)(B). See Community Bank of Homewood-Flossmoor v. Bailey (In re Bailey) 145 B.R. 919, 930 (Bankr. N.D. Ill. 1992). See also Signet Bank/Virginia v. Wingo (In re Wingo), 113 B.R. 249 (W.D. Va. 1989) (failure to disclose contingent liabilities).
7. Plaintiff has argued that the Financial Statement misrepresented the Debtor’s financial status for the following reasons: (1) the Galena Property was overvalued; (2) the Debtor never held legal title to the Massachusetts Property; (3) the New York Property might have been sold before July 1996; and (4) contingent liabilities were not reported on the Financial Statement.
8. With respect to this last contention, Plaintiff has not rebutted the Debtor’s testimony that most of the contingent liabilities arose after the Financial Statement was prepared in July 1995. Since those contingent liabilities necessarily could not have appeared on the Financial Statement, the argument is that the Debtor had a duty to update the statement so as to include those liabilities. As the Debtor observes, Plaintiff has neither identified lawsuits pending as of July 1996 or presented evidence that would quantify the Debtor’s potential liabilities in those suits.
9. Language on a creditor’s form financial statement may impose a duty to notify the creditor of material changes in a debtor’s financial condition. See, e.g., Northern Trust Co. v. Garman (In re Garman), 643 F.2d 1252, 1259 (7th Cir. 1980); European American Bank v. Launzel-Pennes (In

re Launzel-Pennes), 191 B.R. 6, 12 (Bankr. E.D.N.Y. 1996); Founders Bank of Arizona v. Moore (In re Moore), 118 B.R. 64, 68 (Bankr. N.D. Tex. 1990). IBJ Schroder's form apparently contained language that might have imposed such an obligation, but the Debtor did not sign the form, and any such duty would have run to IBJ Schroder.

10. Here, the Debtor tendered a year-old financial statement to a creditor with whom he had no preexisting relationship. Even assuming there might be a duty to update financial information where a borrower tenders a previously prepared statement to a new creditor, the evidence of record does not establish that there were material adverse changes in the Debtor's financial condition between July 1995 and July 1996.
11. A contingent liability is "[o]ne which is not now fixed and absolute, but which will become so in case of the occurrence of some future and uncertain event." Black's Law Dictionary 291 (5th ed. 1979). Since there is no evidence that any of the lawsuits against the Debtor had proceeded to trial or judgment prior to July 1996, there was uncertainty as to whether the Debtor would ultimately be found liable to the parties bringing suit.
12. Notably, too, the Financial Statement disclosed the existence of a \$3,500,000.00 contingent liability. Given Resnick's willingness to accept that very substantial contingent liability, and in the absence of evidence that would quantify other contingent liabilities, this Court cannot conclude that the omission of contingent liabilities rendered the Financial Statement materially false.
13. Looking to the alleged deficiencies in the Financial Statement, because Plaintiff has presented no evidence as to the value of the Galena Property in 1995, the Court concludes that any overvaluation of the property on the Debtor's part did not make the Financial Statement materially false.

14. The primary issue presented is whether the Financial Statement was materially false because it did not specify whether specific real properties were jointly owned or owned by only one of the two spouses. Although the Financial Statement is clearly designated a joint financial statement, Plaintiff correctly observes that certain of the instructions on the IBJ Schroder form were not observed - most particularly, the directions that title ownership and both cost and current market values of particular holdings should be listed in section D of the Supplemental Schedules. According to Resnick, the Financial Statement created the impression that all assets were owned jointly, misleading him into believing that the Debtor owned at least a fifty percent interest in the real properties on the statement. The testimony at trial indicates that the properties in which the Debtor actually had no interest would be the Massachusetts Property and, perhaps, the New York Property and the North Seminary Property.
15. There have been cases finding material falsity where debtors included assets on an individual statement that were actually held in joint tenancy or wholly owned by a spouse. See, e.g., James Truck Centers, Inc. v. Hodges (In re Hodges), 116 B.R. 558, 561 (Bankr. N.D. Ohio 1990); Hoffman & Kuhn, Inc. v. Branham (In re Branham), 126 B.R. 283, 290 (Bankr. S.D. Ohio 1991), appeal dismissed, 953 F.2d 644 (6th Cir. 1992); Sovran Bank/Memphis v. Dollahite (In re Dollahite), 1989 WL 81023 (Bankr. W.D. Tenn. June 5, 1989). In all those cases, the financial statements at issue were not identified as joint statements. As a consequence of the omission, creditors would have been led to assume that the debtor was the owner of all the assets listed on the statement.
16. Where, as here, a joint financial statement is clearly identified as such, this Court cannot agree that the statement necessarily must be deemed false because it fails to designate whether particular

assets are owned jointly or owned solely by one of the individuals submitting the statement. The preparer of the Debtor's Financial Statement did not comply with all the instructions on the form relating to disclosure of property ownership, but that fact is obvious from a careful review of the statement. The omissions on Schedule D would arguably be a "red flag" alerting the user to the need to verify the information concerning property ownership, but a "red flag" is not a false statement.

17. Having reviewed the omissions and inaccuracies of which Plaintiff complains, the Court finds that Plaintiff has failed to establish that the Financial Statement presented a substantially untruthful picture of the Debtor's financial condition.
18. The analysis does not end here, however, as there is more than one approach to the analysis of materiality under § 523(a)(2)(B).
19. The inquiry into "substantial untruth," with its focus on considerations that normally affect the decision to grant credit, can fairly be described as an objective approach.
20. Many decisions have also employed a more subjective "but for" analysis, which the Seventh Circuit describes as a "recurring guidepost" for determining materiality. Harasymiw, 895 F.2d at 1172; In re Bogstad, 779 F.2d 370, 375 (7th Cir. 1985); Bailey, 145 B.R. at 930 n.7. Under that test, a creditor must establish that "but for" a material misrepresentation, it would not have extended money, property, services or credit. Westbank v. Grossman (In re Grossman), 174 B.R. 972, 984 (Bankr. N.D. Ill. 1994). The Bogstad decision illustrates use of a "but for" analysis.
21. Bogstad observed that where, as here, a creditor has relied on the amount of a debtor's net worth, it is not enough that particular statements on a balance sheet be proven false. Id. at 373. Rather, the financial statement as a whole must be materially false. Id. In Bogstad, a bankruptcy court had

recalculated asset values in a debtor's financial statement, making adjustments to take into account inflated property valuations that had been proven at trial. Finding that the debtor's recalculated net worth would have satisfied the lender's criteria for extending credit, the court then determined that the statement was not materially false. See id. at 373-74. On appeal, the Seventh Circuit affirmed, concluding that because the lender would have made the loan in question even if the statement had accurately reflected the debtor's lower net worth, the debt was dischargeable. Id. at 375.

22. Employing a similar analysis here, Plaintiff has not shown that the Debtor falsely inflated the value of the Galena Property or that he failed to disclose significant contingent liabilities on the Financial Statement. As a result, those alleged deficiencies are not taken into account in the "but for" analysis. Taking into account the Debtor's assertions that he owned no interest in either the New York, North Seminary and Massachusetts Properties, total assets reported on the Financial Statement would be reduced from \$9,625,562.00 to \$4,900,562.00. Correspondingly, total liabilities would be reduced from \$2,375,000.00 to \$1,375,000.00, leaving a net worth of \$3,525,562.00.
23. At trial, Resnick testified that he would have accepted a guarantee backed by assets having a value of \$1,700,000.00, provided there were no liabilities. When confronted with a hypothetical incorporating the same factors as the calculation in the preceding paragraph, Resnick gave the vague answer that he would not have entered into the lease agreement if the Debtor's assets diminished "to the point of making him nervous." Because a net worth of \$3,525,562.00 is not clearly below the very vague credit standards described in Resnick's testimony, this Court finds that Plaintiff has failed to prove by a preponderance of the evidence that "but for" the inclusion of the Debtor's wife's property in the Financial Statement, it would not have entered into the lease

with the Firm.

Intent to Deceive

24. Intent to deceive can either be proven through direct evidence, or logically inferred from a false representation that the debtor knows or should know will induce another to make a loan. In re Sheridan, 57 F.3d 627, 633 (7th Cir. 1995); Shaw Steel, Inc. v. Morris (In re Morris), 230 B.R. 352, 360 (Bankr. N.D. Ill.), aff'd, 240 B.R. 553 (N.D. Ill. 1999), aff'd, 223 F.3d 548 (7th Cir. 2000).
25. A debtor's intent to deceive may also be demonstrated by showing reckless indifference to, or reckless disregard for, the accuracy of the information in a financial statement. Phillips v. Napier (In re Napier), 205 B.R. 900, 907 (Bankr. N.D. Ill. 1997). As an example, in Hodges, intent to deceive was found because the debtor, an experienced businessman, knew that his financial statement inaccurately reflected assets which he did not own. See Hodges, 116 B.R. at 562.
26. Here, there is no direct evidence of intent to deceive. The Debtor's testimony at trial is consistent with an inference that he was indifferent as to the accuracy of the disclosures in the Financial Statement, but the testimony also indicates that the Debtor's attitude would have stemmed from a perception that the lease obligations were relatively small amounts.
27. Importantly, the statute requires a finding of intent to deceive. "Deception" has been defined as "[k]nowingly and willfully making a false statement or representation, express or implied, pertaining to a present or past existing fact." Black's Law Dictionary 366 (5th ed. 1979). Because Plaintiff has not established a materially false representation or omission to support the inference, there can be no finding of intent to deceive.

Reasonableness of Reliance

28. The reasonableness of a creditor's reliance on a materially false statement of financial condition is to be determined on a case-by-case basis. Morris, 223 F.3d at 553. Where a creditor's showing on this element under Code § 523(a)(2)(B) is appropriately challenged, courts may look to whether the creditor took steps to verify the accuracy of the information in the debtor's statement, and whether the creditor followed its normal lending procedures. See, e.g., Harasymiw, 895 F.2d at 1173-74. If, under the circumstances, ordinary prudence would require verification, a creditor cannot be said to have acted reasonably if no verification took place. FDIC v. Smigel (In re Smigel), 90 B.R. 935, 937-38 (Bankr. N.D. Ill. 1988).
29. Generally, though, creditors are not required to conduct an investigation before entering into agreements with prospective debtors. Morris, 223 F.3d at 554. Nor should courts use the reasonable reliance requirement to second-guess a creditor's decision to lend money. E.g., Garman, 643 F.2d at 1257-58.
30. One frequently used guideline is that where there are "red flags" suggesting that a debtor has made a false statement, the creditor has a duty to reasonably investigate before it extends credit or otherwise parts with property for the benefit of the debtor. E.g., Shaw Steel, 230 B.R. at 361, aff'd, 240 B.R. 553 (N.D. Ill. 1999), aff'd, 23 F.3d 548 (7th Cir. 2000).
31. Looking to the documentary evidence and the testimony at trial, Plaintiff sought a guarantee of the rent obligations of a law firm that was presently in the process of downsizing. There is no evidence of prior dealings between the Firm and Plaintiff. Despite Resnick's concern for the financial viability of the Firm, he accepted an unsigned financial statement prepared for another creditor a year earlier, and he made no follow-up inquiries of the Debtor. Although the Financial Statement clearly indicated that it was a joint statement, the Debtor's wife was not a co-guarantor of the

Firm's rental obligations.

32. Without more, there might be sufficient "red flags" here to require some verification of the accuracy of the information in the Financial Statement. Again, though, the determinative factor is that the Financial Statement has not been shown to be materially false. Because the evidence does not show that an investigation would have uncovered any material falsity, it is immaterial whether Plaintiff failed to verify the information in the statement.

CONCLUSION

As noted earlier in this opinion, if any of the elements under Code § 523(a)(2)(B) are not established by a preponderance of the evidence, the indebtedness at issue in this adversary proceeding will be dischargeable. Because Plaintiff has not established that the Financial Statement was materially false, the Court finds for the Debtor.

ENTERED:

Date: November 6, 2000

Hon. Susan Pierson Sonderby
United States Bankruptcy Judge

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

IN RE:)	Chapter 7
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HERBERT BEIGEL,)	No. 97 B 14014
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Defendant.)	
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ORDER

For the reasons stated in its findings of fact and conclusions of law entered on this date, the Court finds that Plaintiff InterServ, L.P. has failed to establish that the indebtedness owed it is nondischargeable under § 523(a)(2)(B) of the Bankruptcy Code. Judgment will therefore be entered in favor of Debtor Herbert Beigel.

ENTERED:

Date: November 6, 2000

SUSAN PIERSON SONDERBY
United States Bankruptcy Judge