

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

Transmittal Sheet for Opinions

Will this opinion be published? No

Bankruptcy Caption: In re Herbert Beigel

Bankruptcy No. 97 B 14014

Adversary Caption: INTERSERV, L.P. v. HERBERT BEIGEL

Adversary No. 97 A 01423

Date of Issuance: May 8, 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

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

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

MEMORANDUM OPINION

Plaintiff, InterServ L.P., (“Plaintiff”) filed a complaint under 11 U.S.C. § 523(a)(2), seeking a determination of nondischargeability of the debt owed to it by the Defendant, Herbert Beigel (“Debtor”). This matter comes before the Court on Plaintiff’s motion for summary judgment pursuant to Federal Rule of Civil Procedure 56, incorporated into bankruptcy proceedings by Rule 7056, and Local Rule 402.

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)(F).

BACKGROUND

In 1996, Plaintiff and the law firm of Beigel, Schy, Lesky, Rifkind, Fedik, Gelber, a professional

corporation, ("Law Firm") entered into negotiations for a commercial lease for office space at 9952 Santa Monica Boulevard, Suite 101, Beverly Hills, California. As a prerequisite to entering into such a lease, Plaintiff requested a personal guaranty from Debtor, as Senior Partner of the Law Firm. Plaintiff also requested a current financial statement from Debtor. Debtor provided a joint financial statement, dated July 12, 1995, reflecting the financial position of Debtor and his wife. The financial statement contained no designations as to whether the assets listed were jointly or individually held by either Debtor or his wife. Plaintiff made no inquiries regarding the financial statement or the assets included in the accounting therein. Plaintiff entered into the commercial lease with the Law Firm on July 16, 1996 for \$7,000.00 per month. The Debtor provided the personal guaranty which was executed on or about July 19, 1996.

On May 6, 1997, Debtor filed a voluntary petition for bankruptcy relief under Chapter 7 of the United States Bankruptcy Code. Plaintiff filed a proof of claim in Debtor's Chapter 7 bankruptcy in the amount of \$110,220.00. Upon review of Debtor's schedules filed in this bankruptcy case, Plaintiff discovered that certain property included in the 1995 financial statement had not been listed in Debtor's 1997 Statement of Financial Affairs and Schedules of Assets.

Plaintiff alleges that Debtor made a materially false statement in writing with respect to his financial condition in the financial statement. Plaintiff further alleges that it relied on this statement when entering into the commercial lease and that Debtor proffered the statement with an intent to deceive Plaintiff. Plaintiff claims that it suffered financial injuries as a result of this statement and that the debt resulting therefrom should be rendered nondischargeable.

Debtor disputes Plaintiff's claim that he made any false statements respecting his financial condition. Debtor alleges that the statements in question were not false and that the joint financial statement provided to Plaintiff clearly identified itself as representing the assets of both Debtor and his wife. Debtor further

states that Plaintiff failed to contact either Debtor or the Law Firm with any questions or concerns related to the financial statement. As a result, Debtor alleges, Plaintiff could not have reasonably relied on the statement as an accurate representation of solely the Debtor's assets. Further, to the extent Plaintiff did rely on the financial statement, Debtor argues that Plaintiff relied on the substantial reported income from the previous two years, and not the valuations of the real estate assets which Plaintiff claims constituted the "false statement."

On October 10, 1997, Plaintiff filed an Adversary Complaint for the Determination for the Dischargeability of Debts, alleging that the debt owed under Debtor's personal guaranty is nondischargeable pursuant to § 523(a)(2)(A) and (B)¹.

On October 6, 1999, Plaintiff filed a motion for summary judgment in its favor on the adversary complaint and filed a statement of undisputed facts pursuant to Local Bankruptcy Rule 402(M)(3)². On December 10, 1999, Debtor filed his response, a memorandum in opposition to Plaintiff's motion, and a statement setting forth certain undisputed facts which support his position.

APPLICABLE STANDARDS

Summary judgment is proper if the pleadings, depositions, answers to interrogatories, and admissions on file, together with any affidavits, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. Celotex Corp. v. Catrett, 477 U.S. 317, 322, 106 S. Ct. 2548, 2552, 91 L. Ed. 2d 265 (1986), Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 585-86, 106 S. Ct. 1348, 1355-56, 89 L. Ed. 2d 538 (1986), Trautvetter v. Quick,

¹ Plaintiff mistakenly refers to "Bankruptcy Code section 523(a)(3)."

² Mistakenly referred to by Plaintiff as "pursuant to Local Rule 403(M)(3)."

916 F.2d 1140, 1147 (7th Cir. 1990). The existence of factual disputes is sufficient to deny summary judgment only if the disputed facts are outcome determinative. UNR Industries, Inc. v. Walker (In re UNR Industries, Inc.), 224 B.R. 664, 665 (Bankr. N.D. Ill. 1998), Jones Truck Lines, Inc. v. Republic Tobacco, Inc., 178 B.R. 999, 1003 (Bankr. N.D. Ill. 1995). The burden is on the moving party to show that no genuine issue of material fact exists. Celotex, 477 U.S. at 322, 106 S. Ct. at 2552, Matsushita, 475 U.S. at 585-87, 106 S. Ct. at 1355-56, Matter of Chicago, Missouri & Western Ry. Co., 156 B.R. 567 (Bankr. N.D. Ill. 1993). This burden is met when the record, as a whole, could not lead a rational trier of fact to find for the non-moving party. Matsushita, 475 U.S. at 586.

The party opposing the motion may not rest upon pleadings, allegations or denials. The response of that party must set forth specific facts showing that there is a genuine issue for trial. Celotex, 477 U.S. at 324, Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). Summary judgment must be entered against a party who fails to show the existence of an essential element of that party's case, and on which that party will bear the burden of proof at trial. Celotex, 477 U.S. at 322. In that situation, there is no genuine issue of material fact since a total failure of proof concerning an essential element of the case renders all other facts immaterial. Id. at 323. Therefore, the moving party is entitled to judgment as a matter of law. Id.

Further, the party seeking to establish an exception to the discharge of a debt bears the burden of proof. In re Martin, 698 F.2d 883, 887 (7th Cir. 1983). The burden of proof required for establishing an exception to discharge is a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 286-87, 112 L. Ed. 2d 755, 111 S. Ct. 654 (1991). To further the policy of providing the debtor a fresh start in bankruptcy, exceptions to discharge are construed strictly against the creditor and liberally in favor of the debtor. Meyer v. Rigdon, 36 F.3d 1375, 1385 (7th Cir. 1994); In re Zarzynski, 771 F.2d 304, 306 (7th

Cir. 1985).

DISCUSSION

Plaintiff's complaint is brought under § 523(a)(2) which provides that a discharge does not discharge any debt --

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

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

(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)(A) and (B).

In its adversary complaint, Plaintiff recites the provisions of both § 523(a)(2)(A) and § 523(a)(2)(B) as bases for nondischargeability and ultimately prays for the debt to “be determined not dischargeable pursuant to § 523 of the Bankruptcy Code.” Section 523(a)(2)(A) governs “false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition,” 11 U.S.C. § 523(a)(2)(A). Thus a violation of § 523(a)(2)(A) cannot rise out of the same statement as a violation of § 523(a)(2)(B) which exclusively involves financial statements. 11 U.S.C. §523(a)(2)(A). *See* 124 Cong.Rec. H11095-96 (daily ed. Sept. 28, 1978); S17412 (daily ed. Oct. 6, 1978) [Subsection (A) is mutually exclusive with subsection (B)]; *See also* Jokay Co. v. Mercado (In re Mercado), 144 B.R. 879 (Bankr. C.D. Cal. 1992); Connecticut National Bank v. Panaia (In re Panaia), 61 B.R. 959 (Bankr. S.D. Ohio 1986). Faced with a similar situation, the court in Gehlhausen v. Olinger (In re Olinger), 160 B.R. 1004 (Bankr. S.D. Ind. 1993), sought a determination of which of the two

statutes was most applicable to the facts in the adversary. The Olinger court resolved the question by determining whether or not the representations made to the plaintiffs constitute statements which concern the debtor's or an insider's financial condition.

It is undisputed that the Debtor owes Plaintiff a debt and that the debt is for money, property or services. However, Plaintiff fails to allege, in its statement of undisputed facts or elsewhere, that Debtor made a false representation other than in Debtor's financial statement. While Plaintiff alleges false representations and "gross recklessness," Plaintiff's claim is inexorably tied to Debtor's financial statement. Because Plaintiff has not presented evidence supporting a separate claim under § 523(a)(2)(A), summary judgment is denied on Plaintiff's claim under that section.

In order to prevail on its claim under § 523(a)(2)(B), Plaintiff must establish that Debtor made a materially false written statement regarding his financial condition, that the statement was made with the intent to deceive, and that creditor relied on that statement. In the Matter of Sheridan, 57 F.3d 627, 633 (7th Cir. 1995), *citing* Matter of Harasyniw, 895 F.2d 1170, 1172 (7th Cir. 1990); Grogan v. Garner, 498 U.S. 279, 287-88, 112 L. Ed. 2d. 755, 111 S. Ct. 654 (1991).

While Debtor alleges that the statements were submitted to Plaintiff by his secretary, the statement itself was composed by Debtor, and Debtor admits that he provided the Plaintiff with a Joint Financial Statement. It is also undisputed that the statements involved were statements respecting the Debtor's financial condition. However, the statement was a joint one which did not distinguish ownership. Both Plaintiff and Debtor agree that the Joint Financial Statement did not distinguish ownership of any Real Property between Debtor and his wife. Plaintiff argues that the listing of assets held by an applicant's wife as one's own may constitute a materially false statement and cites In re Hodges, 116 B.R. 558, 560

(Bankr. N.D. Ohio 1990) for support.

In Hodges, like the present matter, the plaintiff filed a complaint under § 523(a)(2)(B) pertaining to a financial statement submitted by the debtor therein which actually depicted assets held by both the debtor in the case and his wife. In Hodges, the court found the debt nondischargeable under § 523(a)(2)(B). In re Hodges, 116 B.R. at 562. Nevertheless, Hodges must be distinguished from the present case because, in Hodges there was no evidence of any acknowledgment or statement that the financial statement in question represented the assets of the debtor therein and his wife. In the present case, the document tendered to Plaintiff explicitly stated that it was a Joint Financial Statement representing the assets and liabilities of Debtor and his wife. *See* Joint Financial Statement, Plaintiff's Ex. 5. The cover sheet and the "Personal Information" section of the Financial Statement prominently contain the names of both Debtor and his wife, and both names can be found on other documents throughout the financial statement. Plaintiff has not alleged that any of the assets listed in the Joint Financial Statement were assets which were not actually held by either Debtor or his wife. Plaintiff does not allege that any of the statements or accountings contained in the financial statement were actually false. Drawing inferences in favor of the Debtor, there is a question of fact as to whether the statement was false.

Assuming, *arguendo* that the financial statement or provisions therein were considered false representations, there are additional disputes as to whether such a statement can be considered materially false and whether Plaintiff actually relied on the information in the financial statement concerning Debtor's assets. Debtor alleges that Plaintiff knew that the substantial income listed in the financial statement was income from Debtor's practice of law and based its leasing decision on the substantial sums depicted, rather than on the real property assets listed, which comprised a somewhat smaller portion of the joint financial statement. The annual rent for the commercial lease was \$84,000, while the financial statement reported

income from the two previous years of approximately \$10,000,000.00. Further, the statement showed assets, exclusive of the most valuable property held by Debtor's wife, with a net worth in excess of \$4,000,000.

Courts in the Seventh Circuit have utilized two different tests to determine if a statement can be designated "materially false" for purposes of § 523(a)(2)(B), using both the "substantial untruth" test and the "but for" test. Shaw Steel, Inc. v. Morris (In re Morris), 230 B.R. 352, 358 (Bankr. N.D.Ill. 1999). Under the "substantial untruth" test, a 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." In re Morris, 230 B.R. at 358 *citing* Banner Oil Co v. Bryson (In re Bryson), 187 B.R. 939, 962 (Bankr.N.D.Ill.1995) (internal citation omitted). The "but for" test requires a creditor to establish that "but for" the material misrepresentation, he would not have extended money, property, services, or credit. In re Morris, 230 B.R. at 358, fn. 2 *citing* Westbank v. Grossman (In re Grossman), 174 B.R. 972, 984 (Bankr.N.D.Ill.1994). Under either test, Debtor's allegations are sufficient to demonstrate a genuine issue of material fact as to whether the allegedly false statement, concerning the real property actually held by Debtor's wife would constitute a materially false statement.

As stated above, Plaintiff must also prove the requisite reliance on the allegedly false financial statement. Plaintiff points out that there is a lack of clear consensus in the Seventh Circuit as to the standard of reliance required, arguing that "justifiable reliance" is the proper standard to be applied. Plaintiff erroneously bases this argument on Judge Squires' discussion of reliance in In re Arlington 192 B.R. 494, 498 (Bankr. N.D. Ill. 1996). While Judge Squires' analysis appears sound, it concerns the correct standard or reliance to be applied in § 523(a)(2)(A) matters. The text of § 523(a)(2)(B) explicitly refers to a statement in writing "on which the creditor to whom the debtor is liable for such money, property,

services, or credit reasonably relied.” 11 U.S.C. §523(a)(2)(B)(iii). While Plaintiff has alleged that it would not have entered into the lease without a current financial statement from Debtor and that it relied on the statement tendered in entering into the lease, there is a question of fact as to whether Plaintiff actually relied on the portions of the financial statement which were allegedly false. The statement is identified as a joint financial statement and Debtor alleges that, absent inquiry about the joint nature of the statement and the ownership of the assets, Plaintiff could not have reasonably relied on the statement as being a statement reflecting solely Debtor’s assets.

While Debtor also disputes whether Plaintiff has sufficiently demonstrated the requisite intent to deceive, the Court need not address this issue here. Debtor has demonstrated that genuine issues of material fact thus exist as to: (1) whether the statement made by Debtor through the financial statement was false; (2) whether the allegedly false statement was material; and (3) whether Plaintiff reasonably relied on it.

CONCLUSION

Plaintiff has failed to meet its burden to demonstrate that it is entitled to judgment as a matter of law and that no genuine issues of material fact exist. Debtor has demonstrated genuine issues of material fact relating Plaintiff’s claim under § 523(a)(2). Therefore, Plaintiff’s motion for summary judgment is denied.

This adversary proceeding is set for status on May 23, 2000 at 10:30 a.m.

ENTERED:

Date:

Hon. Susan Pierson Sonderby
United States Bankruptcy Judge