

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

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U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
CLEVELAND, OHIO

IN RE:

Michael Gabriel, Sr.
Debtor.

In Proceedings Under Chapter 7
Case No.: 08-18253

Adv. Proc. No.: 09-01048

Kufr Group, LLC
Plaintiff.

vs.

Michael Gabriel, Sr.
Defendant.

JUDGE RANDOLPH BAXTER

MEMORANDUM OF OPINION AND ORDER

Herein, the Plaintiff, Kufr Group, LLC (Kufr Group), seeks a determination of debt dischargeability pursuant to §§ 523(a)(2)(A), (a)(2)(B), (a)(4) and (a)(6) of the Bankruptcy Code. Michael Gabriel, Sr., the Debtor, opposes the relief sought. This adversary proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(J), with jurisdiction further conferred under 28 U.S.C. § 1334 and General Order No. 84 of the District. Upon the conclusion of a duly noticed trial proceeding and the consideration of the parties' respective briefs, arguments of counsel, testimony of witnesses and an examination of the record, generally, the following findings of fact and conclusions of law are hereby rendered:

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The Debtor filed a petition for relief under Chapter 7 of the Bankruptcy Code on October 24, 2008. Prior to filing his bankruptcy petition, the Debtor and his former wife entered into a twelve (12) month lease agreement for the rental of a condominium with Kufr Group. The condominium, located at 3542 West 210th Street, was apart of a duplex in which the Gabriels rented the downstairs apartment while the upstairs apartment was occupied by other tenants. At the time of the execution of the lease agreement, Kufr Group did not request any references, nor

did it conduct a credit search of their credit history or make a request for a credit report. The only alleged document referencing the Gabriels' financial history was a rental application that the Debtor denies filling out and was never produced by Kufr Group.

The lease agreement required the Gabriels to submit \$675 for rent to Kufr Group by the fifth (5th) of each month. The parties also agreed to a security deposit of \$675. Due to the Gabriels' financial constraints, the parties agreed for the security deposit to be paid over a period of two (2) months. Oleksa Direct. Upon signing the lease agreement, the Gabriels paid \$675 for September's rent.¹ Exh. 4. They moved into the apartment several weeks later at the end of August 2006. Gabriel Cross-Exam. Subsequent rent payments and the security deposit, however, were never made. Consequently, the Gabriels were given a three (3) day notice to leave said premises on November 10, 2006. Exh. 2. Despite receiving the three day notice, they failed to leave the premises and eviction proceedings were commenced in December 2006 in the Rocky River, Ohio Municipal Court. Zigman Direct.

Judgment was entered in favor of Kufr Group and against the Gabriels for non-payment of rent. The Debtor's wages were garnished to pay said judgment. Approximately one and a half years later, the Debtor filed for bankruptcy relief. Subsequently, Kufr Group commenced this adversary proceeding alleging that the debt was fraudulently incurred and, therefore, should be deemed nondischargeable pursuant to §523(a) of the Bankruptcy Code. [11 U.S.C. §523(a)].

Kufr Group alleges that the Debtor engaged in a series of fraudulent representations made to several rental companies. According to Kufr Group, the Debtor and his former wife lived in six apartments during a course of five years. During each tenancy, excluding his current

¹Although the lease agreement states that \$675 was for the security deposit, one receipt indicates that the funds were used for September's rent. Exh. 4

residence, they were served eviction notices and, in several instances, eviction proceedings were commenced against them. Kufr Group alleges that the Debtor and his former wife did not have the income to pay the rent during each tenancy. It asserts that they entered into the lease agreements fully aware of their inability to afford the rent. This essentially, Kufr Group argues, amounted to fraudulent misrepresentation. Kufr Group also alleges that fraud arose when the Gabriels were not forthcoming about prior eviction proceedings involving other rental companies. Kufr Group asserts that it would not have agreed to rent to the Gabriels had it been aware of their past rental history. Oleska Direct; Zigman, Direct.

The Debtor contends that he did not defraud Kufr Group. He asserts that he did not divulge prior eviction proceedings to Kufr Group because he did not believe they were relevant. Gabriel, Direct. Specifically, the Debtor asserts that despite the fact that eviction proceedings were commenced none were ever completed because of his ability to cure all arrears. The Debtor asserts that unforeseen events created his financial hardships and denies that these hardships were fabricated to defraud creditors. These financial constraints made it difficult for him to afford his rent and pay his bills. When his former wife became injured, the Debtor asserts that her lack of income put a greater strain on their finances. Gabriel, Direct; Gabriel, Cross Exam.

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The Court must determine whether the debt owed to Kufr Group is non-dischargeable pursuant to §523(a)(2)(A) or §523(a)(2)(B). ²

²The underlying complaint sought relief under four subsections of §523 including (a)(2)(A), (a)(2)(B), (a)(4), and (a)(6). After closing arguments, Kufr Group's attorney conceded a lack of prosecution under subsections 523(a)(4) and (a)(6) and only wished to pursue its fraud claims under §§523(a)(2)(A) and (a)(2)(B).

Kufr group seeks relief pursuant to §§ 523(a)(2)(A) and 523(a)(2)(B), which provides in relevant part:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from 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 statement respecting the debtor’s or an insider’s financial condition; (B) Use of a statement in writing –(i) That is materially false; Respecting the debtor’s or an insider’s financial condition; (ii) On which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and (iii) that the debtor caused to be made or published with intent to deceive[.]

11 U.S.C §523(a)(2)(A),(B). A creditor seeking relief under §523(a)(2) has the burden of proving each element by a preponderance of the evidence that a debt is nondischargeable.

Providian Bancorp v. Shartz (In re Shartz), 221 B.R. 397, 399 (6th Cir. BAP 1998) (citing *Grogan v. Garner*, 498 U.S. 279, 286-287, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991)).

Section 523(a)(2)(A) :

A creditor seeking relief under §523(a)(2)(A) must demonstrate that the property (or debt) was obtained by false pretenses, a false representation or actual fraud. A showing of only one of the three conducts is required to satisfy §523(a)(2)(A). *James v. McCoy (In re McCoy)*, 114 B.R. 489, 498 (Bankr.S.D.Ohio 1990). “False pretenses” involves “an implied misrepresentation or conduct intended to create or foster a false impression.” *In re Finch*, 289 B.R. 638, 643 (Bankr.S.D. Ohio 2003). While, “false representation” is defined as an expressed misrepresentation...[that] need not be written.” *In re Hoover*, 232 B.R. 695, 700 (Bankr.S.D. Ohio 1999). Fraud refers to actual or positive fraud and not fraud implied in law. 1978 U.S.Code Cong. & Ad.News 5787, 6453. Positive fraud is distinguishable from implied fraud

by the existence of scienter. *In re Fletcher*, 345 B.R. 592, 597 (Bkrtcy.N.D.Ohio,2006); *A.T. & T v. Mercer (In re Mercer)*, 246 F.3d 391, 407 (5th Cir.2001) (en banc). Scienter involves moral turpitude or intentional wrong, and thus carries with it, “a mental state embracing intent to deceive, manipulate, or defraud.” *Id.*; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 fn. 12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976) (interpreting scienter for purposes of securities law). Finally, a showing of fraud can either be found in the debtor’s overall conduct or in his failure to disclose “subsequently acquired information.”³

To prevail on a claim for false pretenses, false representation or actual fraud the movant must show that: (1) the debtor obtained money 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 the creditor’s loss. *Rembert v. AT & T Universal Card Servs., Inc. (In re Rembert)*, 141 F.3d 277, 280-81 (6th Cir.1998) (footnote omitted) (citing *Longo v. McLaren (In re McLaren)*, 3 F.3d 958, 961 (6th Cir.1993)).

The first element is straight forward and encompasses an express or an implied representation. The second element requires the creditor to show that the debtor’s representations were made with the intent to deceive. *Rembert*, 141 F.3d at 280. When determining a debtor's intent to deceive “the proper inquiry is whether the debtor subjectively intended to repay the debt,” which is not measured by his ability to repay the debt. *Id.* at 281. Instead, the focus should be on whether the debtor maliciously and in bad faith incurred the debt with the “intention of petitioning for bankruptcy and avoiding the debt.” *Id.* Since it is unlikely a

³ See Restatement (Second) of Torts §551 (1977).

debtor will admit to a deceitful act to defraud, it is necessary to examine the totality of the circumstances surrounding the alleged fraudulent representation, which may include: timing of events, the debtor's insolvency, or transfers of money to family members or insiders. *In re Lupo*, 353 B.R. 534, 546 -547 (Bankr.N.D. Ohio 2006); *EDM v. Harrison (In re Harrison)*, 301 B.R. 849, 854 (Bankr.N.D. Ohio 2003); *See Bernard Lumber Co. v. Patrick (In re Patrick)*, 265 B.R. 782, 786 (Bankr.N.D. Ohio 2001). Lastly, for the purposes of this subsection, the failure to fulfill a promise, alone, is insufficient to base a finding of fraudulent intent. *In re Mills*, 345 B.R. 598, 604 (Bankr.N.D. Ohio 2006), *citing Jacobs v. Ballard (In re Ballard)*, 26 B.R. 981, 985 (Bankr.D. Conn. 1983).

The third element of the § 523(a)(2)(A) dischargeability fraud test requires a creditor to establish that it justifiably relied on a debtor's false representation. *Field v. Mans*, 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). A creditor is justified in relying on a debtor's representation even if he might have "ascertained the falsity of the representation had he made an investigation." *Id.* at 70.

The fourth and final element requires a creditor to show that the false representation of the debtor was the proximate cause of its loss. "Proximate cause is something more than 'speculation as to what the creditor might have done in hypothetical circumstances.'" *In re Lupo*, 353 B.R. 534, 547 (Bankr.N.D. Ohio 2006) (quoting *Siriani v. Northwestern Nat'l Ins. Co. (In re Siriani)*, 967 F.2d 302, 306 (9th Cir. 1992)). It depends "on whether the [debtor's] conduct has been so significant and important a cause that the [debtor] should be legally responsible." *Britton v. Price (In re Britton)*, 950 F.2d 602, 604 (9th Cir. 1991); *see also United States v. Spicer*, 57 F.3d 1152, 1157 (D.C. Cir. 1995). In summary, there must be "a direct link between the alleged fraud and the creation of the debt." *In re Spigel*, 260 F.3d 27, 32 n. 7 (1st Cir. 2001).

Herein, Kufr Group contends that the Debtor's failure to pay rent over the past several years demonstrates a continual pattern of fraudulent behavior. Kufr Group, however, provided no evidence to support its contention that the Debtor's defrauded former landlords. The only evidence introduced to support its contention was the lease agreement which indicated the Debtor's promise to pay rent. Although the Debtor attributed his past failure to pay rent on medical bills, he testified that he did not pay rent with Kufr Group because of its failure to abide by the lease agreement. Specifically, he argued that he was promised garage space but was never given use of the space for his vehicle. This argument, however, is not supported by the lease agreement.

Paragraph six (6) of the agreement leaves space for the parties to indicate their intentions regarding parking and storage. The space was left blank which indicates there was no express agreement between the parties regarding the use of garage space. Furthermore, the agreement contains a merger clause which provides that the agreement would be the full and final intentions of the parties and that it would supersede any oral or written representations that were made by either party. Exh. 1-5, para. 24. Gabriel, Direct; Gabriel, Cross Exam. The lease agreement does require the Debtor to pay rent. A mere promise to pay, however, is insufficient to carry the requisite burden to show fraudulent intent pursuant to §523(a)(2)(A).

Kufr Group also asserts that the Debtor's inability to pay is equivalent to fraudulent misrepresentation. Case law, however, provides otherwise. Specifically, fraud arises not from the debtor's inability to pay but is determined by whether the debtor maliciously incurred the debt with the intention of filing for bankruptcy to avoid paying said debt. *Supra*, 141 F.3d at 281. No evidence was provided to show that the Debtor intended to incur the debt in order to have it discharged in bankruptcy.

During the Gabriels tenancy with previous rental properties, the Debtor's wife suffered psychotic episodes, on the job injuries, and paralysis. Gabriel, Direct; See Exh. 3. Prior to each event, they depended on her income to help pay for their daily living expenses. Id. Each time she became incapacitated, the Gabriels' income was adversely affected, making it difficult for them to pay bills including their rent. Gabriel, Direct. Their income was further impacted by garnishments from past judgments. The Debtor engaged in poor financial decisions by renting apartments that were too expensive for him to pay with his salary alone. He rented those apartments under the assumption that the disability benefits his wife received would not end. Gabriel, Direct. When the benefits stopped temporarily, the Gabriels found themselves financially strained. The Debtor's poor decision making, however, does not rise to the level of fraud as fraud requires scienter which involves manipulation and moral turpitude. None of which was proven to exist in this case.

Although the Debtor's testimony was credible, his credibility was affected by the fact that he failed to disclose pertinent rental information to Kufr Group at the time the lease agreement was signed. The Debtor reasoned that, since he cured the arrears prior to judgment being rendered during each eviction proceeding, disclosure was not necessary. This reasoning, although flawed, rebutted Kufr Group's contention that the Debtor incurred the debt without an intention to repay it. No evidence to refute the Debtor's representation was produced by Kufr Group.

Herein, Kufr Group was reposed with the burden to show that the debt was fraudulently incurred by the Debtor. Although all the witness were credible, Kufr Group failed to establish its prima facie case that the Debtor had the requisite intent to make a fraudulent representation in

which it detrimentally relied. Thus, Count I of the Complaint pursuant to §523(a)(2)(A) is hereby determined to be without merit and is denied.

Section 523(a)(2)(B) :

Kufr Group also seeks relief pursuant to § 523(a)(2)(B) of the Bankruptcy Code. For purposes of § 523(a)(2)(B), a written statement respecting a debtor's financial condition may be described as one representing the debtor's net worth, overall financial health, or ability to generate income so as to enable an accurate assessment of the debtor's creditworthiness. *In re Joelson*, 427 F.3d 700 (10th Cir.2005). *In re Sharp*, 357 B.R. 760, 765 (Bankr.N.D. Ohio 2007). Once it has been established that the alleged fraud arose as the result of a written statement respecting the debtor's financial condition, the creditor must show, by a preponderance of the evidence, these additional three elements: 1) the existence of a materially false statement; 2) the creditor's reasonable reliance on the false statement; and 3) the debtor's intent to deceive by making the statement. *In re Carmen*, 723 F.2d 16, 16-17 (6th Cir.1983).

Herein, Kufr Group relies on the Debtor's rental application as the written statement necessary to establish fraud pursuant to §523(a)(2)(B). The alleged rental application, however, was never produced or placed into evidence for trial. Indeed, the parties disputed whether an application was ever executed by the Debtor. The only document demonstrated was the lease agreement. The lease agreement, however, does not qualify as a written statement under this subsection as it does not describe the debtor's net worth, financial health or ability to generate income. See Exh. 1. Kufr Group acknowledges that no other inquiry regarding the debtor's financial condition was made. Zigman, Cross-Exam. Having provided no proof that Kufr Group was in receipt of a qualifying written statement regarding the Debtor's financial condition, Kufr Group has failed to show the first and most crucial element of §523(a)(2)(B).

Thusly, no basis has been established by the Plaintiff, Kufr Group, to support nondischargeability under §523(a)(2)(B).

Gabriel's Attorney's Fees :

The American Rule on attorney fees requires each party to pay their own attorney's fees absent other statutory direction. *See Key Tronic Corp. v. United States*, 511 U.S. 809, 814-15, 114 S.Ct. 1960, 128 L.Ed.2d 797 (1994); *Alyeska Pipeline Svc. Co. v. Wilderness Soc.*, 421 U.S. 240, 247, 95 S.Ct. 1612, 44 L.Ed.2d 141 (1975). Section 523(d) provides such statutory direction and allows for attorney fees to be awarded to the prevailing party on a complaint for exception to discharge under §523(a)(2). This section is designed to deter "creditors from initiating meritless actions based on §523(a)(2) in the hope of obtaining a settlement from an honest debtor anxious to save attorneys' fees." *First Card v. Carolan (In re Carolan)*, 204 B.R. 980, 987 (9th Cir. BAP 1996); *In re Williams*, 224 B.R. 523, 529 -530 (2nd Cir.BAP 1998).

Section 523(d) provides in relevant part:

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 a 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.

11 U.S.C. §523(d).

This Court has previously determined that, for a debtor to maintain a successful motion for costs and fees under §523(d), the debtor must show that 1) the creditor filed a dischargeability complaint under §523(a)(2); 2) the complaint concerned a consumer debt; 3) the debt was found dischargeable; 4) the position of the creditor was not substantially justified; and 5) no special circumstances exist to make an award unjust. *In re Thomas*, 258 B.R. 167, 168

(Bankr.N.D. Ohio 2001). The initial burden falls on the debtor to show that the creditor brought an unsuccessful complaint on the discharge of a consumer debt. The burden then shifts to the creditor to prove substantial justification or special circumstances by a preponderance of the evidence. *In re Harvey*, 172 B.R. 314, 318 (9th Cir. BAP 1994); *Thomas*, 258 B.R. at 168; *In re Goss*, 149 B.R. 460 (Bankr.E.D. Mich 1992).

Herein, Gabriel meets his burden for a prima facie case for the award of attorney fees. It has been established that Kufr Group filed a dischargeability complaint under §523(a)(2) regarding consumer debts. As determined herein, the complaint allegations are without merit, thereby rendering Kufr Group's claim unsuccessful. It is now incumbent upon Kufr Group to show by the preponderance of the evidence standard that it was substantially justified in prosecuting its claim.

The Supreme Court in *Pierce v. Underwood* held that substantial justification requires reasonableness. 487 U.S. 552 (1988). A position can be justified even though it is not correct, and may be substantially justified if a reasonable person could think it correct, that is, if it has a reasonable basis in law and fact. *Pierce*, 487 U.S. at 566, n. 2, 108 S.Ct. 2541. Although some courts have developed a three-part test, this Court has previously found that substantial justification is determined by the totality of the circumstances. *Thomas*, 258 B.R. at 169; *In re Miller*, 250 B.R. 294, 296 (Bankr.E.D. Ky 2000)(quoting *In re Williams*, 224 B.R. 523, 531(2nd Cir. BAP 1998). Lastly, the creditor must be substantially justified at all times through trial in order to be insulated from paying attorney fees. *See In re Carolan* , 204 B.R. 980 (9th Cir. BAP 1996); *Harvey*, 172 B.R. at 318-19.

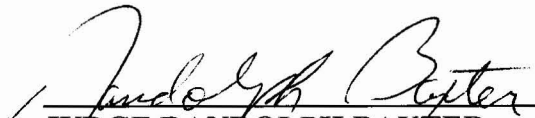
Kufr Group was not substantially justified to bring its complaint alleging fraud pursuant to §§523(a)(2)(A), (a)(2)(B), (a)(4), (a)(6). Firstly, Kufr Group conceded §§ 523(a)(4) and (a)(6)

for lack of sufficient evidence regarding key elements of these two claims. No fiduciary relationship existed prior to the lease agreement between Kufu Group and the Debtor pursuant to §523(a)(4) and Kufu Group did not meet its burden to show a willful or malicious injury by the Debtor occurred as required by §523(a)(6). Second, no written document regarding the Debtor's financial condition was ever produced. Again providing no basis for Kufu Group to bring a claim against the Debtor pursuant to §523(a)(2)(B). Finally, keeping in mind that the plaintiff at all times carries the burden of proof in order to succeed on a claim pursuant to §523(a)(2)(A), Kufu Group failed to meet such burden regarding the Debtor's intent. Although it is not necessary for Kufu Group to be correct in its claim against the Debtor, its claim had to be reasonably based in law and in fact. However, it often relied on erroneous arguments not supported by the Bankruptcy Code or corresponding case law. Furthermore, the facts show an overwhelming absence of fraud in this case. Due diligence could have led Kufu Group to the conclusion that its claim was not substantially justified. Thus, this Court finds that the Debtor, Michael Gabriel, Sr., is entitled to reasonable attorney's fees.

Accordingly, judgment is hereby rendered in favor of the Debtor. The Complaint is dismissed. Costs and fees are hereby awarded to the Debtor.

IT IS SO ORDERED.

Dated, this 21st day of
September, 2009


JUDGE RANDOLPH BAXTER
UNITED STATES BANKRUPTCY
COURT