

IT IS SO ORDERED.

Dated: 05:28 PM December 20 2010



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

IN RE:)	CASE NO. 09-53956
)	
SALVATORE A. REGO,)	CHAPTER 7
)	
DEBTOR(S))	JUDGE MARILYN SHEA-STONUM
)	
TIMBER RIDGE INVESTMENT, LTD.,)	ADVERSARY NO. 10-5013
)	
PLAINTIFF(S),)	
)	
vs.)	
)	
SALVATORE A. REGO)	MEMORANDUM OPINION
)	
DEFENDANT(S).)	

This matter comes before the Court on a complaint to determine the dischargeability of debt. A trial in this matter was held on November 1, 2010 during which evidence was presented in the form of exhibits as well as testimony from (1) Salvatore Rego, defendant-debtor; (2) Sam Petros, principal of plaintiff, Timber Ridge Investment, Ltd. ("Timber Ridge"); (3) Lidia Richani, commercial real estate leasing agent; and (4) Mark C. Rowland, accountant for Sam Petros. At the conclusion of the trial, the Court took the matter under advisement.

This proceeding arises in a case referred to this Court by the Standing Order of Reference entered in this District on July 16, 1984. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (I) over which this Court has jurisdiction pursuant to 28 U.S.C. § 1334(b). Based upon testimony and evidence presented at the trial, the arguments of counsel, the pleadings in this adversary proceeding and defendant-debtor's main chapter 7 case and pursuant to FED. R. BANKR. P. 7052, the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. Salvatore Rego is a member of the Rego family which is well know for operating grocery stores throughout northeast Ohio. At one time the family owned 56 grocery stores that employed approximately 6,000 people.

2. Salvatore Rego graduated from high school in 1965 and, aside from 4 years in the Navy, he has worked in the family's grocery business all of his adult life.

3. For the past 20 years, Salvatore Rego has been a part owner with his three brothers of several different grocery stores.

4. Timber Ridge is an Ohio Limited partnership. Sam Petros owns a 72% interest in Timber Ridge and is its managing partner.

5. Timber Ridge owns and leases commercial property. Sam Petros is responsible for negotiating and entering into leases on behalf of Timber Ridge as landlord. Mr. Petros is also responsible for deciding whether Timber Ridge will advance funds to tenants to assist with preparing a space for occupancy and, if so, the amount to be loaned.

6. In 2007 Timber Ridge owned a strip shopping center known as Timber Ridge Plaza located in North Royalton, Ohio. The one anchor tenant of Timber Ridge Plaza is a grocery store.

7. In mid 2007 Sam Petros began looking for a grocery store tenant to let the then vacant anchor tenant space at Timber Ridge Plaza. Assisting Mr. Petros with finding another tenant was Lidia Richani a commercial real estate leasing agent. Mr. Petros was aware of the Rego family's reputation in the grocery business and he contacted Salvatore Rego to discuss the vacancy.

8. Over the course of approximately six months, Mr. Petros and Salvatore Rego met three times to discuss the anchor tenant space. During that time Mr. Petros asked Mr. Rego to provide him with a personal financial statement.

9. Salvatore Rego provided Timber Ridge with a document captioned "Personal Financial Statement" (the "Financial Statement") which was dated April 30, 2007 and indicated that Mr. Rego had a positive net worth of \$4,563,300. The Financial Statement is a one page document that includes references to schedules. The copy initially provided to Timber Ridge had no schedules attached. At some later date another copy of the Financial Statement was provided to Timber Ridge and included two pages of schedules.

10. The two largest assets listed on the Financial Statement are \$4,074,000 in "Investment - Bonds & Stocks (Schedule 2)" and \$530,000 in "Real Estate Owned (Schedule 4)."

11. Mr. Rego is a beneficiary of a trust created under the Last Will and Testament of his father, Sam Rego, dated July 27, 1976 (the "Trust"). The Trust contains a spendthrift provision and Mr. Rego has no control over the investments or distributions of the Trust. Included in the \$4,074,000 figure on the Financial Statement was Mr. Rego's 25% beneficial interest in the Trust. Mr. Rego's interest in the trust was listed on Schedule 2 as having a value of \$2,250,000.

12. Pursuant to a separation agreement dated May 12, 2004 and entered into during Mr. Rego's second marriage (the "Separation Agreement"), Mr. Rego is required to pay over to his second wife, Judith Rego, 20% of the net principal distribution paid to Mr. Rego from the Trust. That

distribution of principal has not yet been made and the 20% obligation to Judith Rego was not deducted from the \$2,250,000 value listed on the Financial Statement for Mr. Regos' interest in the Trust.

13. Included in the \$530,000 figure on the Financial Statement for real estate was residential real property located on East River Road in Columbia Station, Ohio. That property was listed on Schedule 4 as having a value of \$350,000 and no mortgage lender or other obligation thereon is identified. In January 2000 Mr. Rego and Judith Rego (his wife at that time) entered into a \$175,000 "Private Equity Line Agreement" with National City Bank and granted the bank a mortgage on the Columbia Station property as security. Pursuant to the Separation Agreement Mr. Rego is obligated to pay to Judith Rego from his portion of the proceeds of the sale of the Columbia Station property: (i) the balance then due and owing on the \$175,000 private equity line and (ii) \$173,500 in return for her disclaimer of interest in his various business entities.

14. At the time the Financial Statement was delivered to Timber Ridge the Columbia Station property had not been sold and was still encumbered with the National City Bank mortgage. Mr. Rego's obligation to Judith Rego under the Separation Agreement was also still in effect.

15. Neither Sam Petros nor any employee of Timber Ridge ever contacted Mr. Rego or the accountant who assisted Mr. Rego in preparing the Financial Statement with any questions pertaining to that document.

16. On or about December 12, 2007 Timber Ridge, as landlord, and Salvatore Rego, as tenant, entered into a "Business Property Lease" for the anchor tenant space at Timber Ridge Plaza (the "Lease"). The commencement date under the Lease was March 1, 2008.

17. Timber Ridge advanced funds to Mr. Rego to assist him with preparing the anchor space for occupancy. In exchange for those funds Mr. Rego signed a \$350,000 “Variable Rate Cognovit Promissory Note” (the “Cognovit Note”).

18. Mr. Rego opened a grocery store in the anchor tenant space at Timber Ridge Plaza. The store experienced financial difficulties from its start and ultimately closed in November or December of 2008.

19. On or about January 12, 2009 Timber Ridge obtained a judgment against Mr. Rego on the Cognovit Note.

20. Mr. Rego filed a voluntary chapter 7 bankruptcy petition on September 2, 2009.

21. Timber Ridge filed two proofs of claim in Mr. Rego’s bankruptcy case. One proof of claim is for \$1,086,388.79 on account of a breach of the Lease and the other is for \$393,908.57 on account of the Cognovit Note judgment. Mr. Rego does not dispute the validity or amount of either of those proofs of claim.

DISCUSSION

Timber Ridge contends that the debt owed to it by Mr. Rego should be excepted from Mr. Rego’s chapter 7 discharge pursuant to 11 U.S.C. § 523(a)(2)(B).¹ Section 523(a)(2)(B) excepts from discharge any debt

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

¹ In its complaint Timber Ridge also objected to the dischargeability of its debt pursuant to § 523(a)(6) of the Bankruptcy Code. On October 21, 2010 the Court issued an Opinion and Order granting defendant-debtor’s motion for summary judgment on the counts in the complaint dealing with § 523(a)(6). Accordingly, the only causes of action dealt with at trial were those challenging dischargeability pursuant to 11 U.S.C. § 523(a)(2)(B).

- (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. . . .

Timber Ridge bears the burden of proving each element of § 523(a)(2)(B) by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279 (1991); *Barclays/American Business Credit, Inc. v. Adams (In re Adams)*, 31 F.3d 389, 394 (6th Cir. 1994). In determining whether a plaintiff has proved the necessary elements of its case, the bankruptcy court, as trier of fact, must weigh conflicting facts, determine the credibility of witnesses and draw inferences from the evidence presented. *Investors Credit Corp. v. Batie (In re Batie)*, 995 F.2d 85, 88 (6th Cir. 1993); FED. R. BANKR. P. 8013.

During trial Mr. Rego, through counsel, stipulated that the information in the Financial Statement was not correct. However, to satisfy the first element of an action under § 523(a)(2)(B), Timber Ridge must show that the information in the Financial Statement was “materially false.” For a financial statement to be considered “materially false,” it must be “one which paints a substantially untruthful picture of the debtor’s financial condition by misrepresenting information of the type which would normally affect the decision to grant credit.” *Fifth Third Bank v. Collier (In re Collier)*, 231 B.R. 618, 623 (Bankr. N.D. Ohio 1999) (citation omitted).

Mr. Rego’s failure to factor his obligations to Judith Rego under the Separation Agreement into the valuation of his interest in the Trust and the Columbia Station property led to a significantly inaccurate assessment of his net worth. Because an individual’s net worth is the type of information which would normally affect a decision about whether or not to grant credit, the Financial Statement

constitutes a materially false statement regarding Mr. Rego's financial condition. Accordingly, Timber Ridge has satisfied the first two elements of a cause of action under § 523(a)(2)(B).

Timber Ridge must also demonstrate that it reasonably relied upon the Financial Statement when making its decision to enter into the Lease with Mr. Rego and advance him funds to get the vacant leasehold space ready for occupancy.

Whether a creditor's reliance was reasonable is a factual determination to be made in light of the totality of the circumstances. Among the circumstances that might affect the reasonableness of a creditor's reliance are: (1) whether the creditor had a close personal relationship or friendship with the debtor; (2) whether there had been previous business dealings with the debtor that gave rise to a relationship of trust; (3) whether the debt was incurred for personal or commercial reasons; (4) whether there were any "red flags" that would have alerted an ordinarily prudent lender to the possibility that the representations relied upon were not accurate; and (5) whether even minimal investigation would have revealed the inaccuracy of the debtor's representations.

BancBoston Mortgage Corp. v. Ledford (In re Ledford), 970 F.2d 1556, 1560 (6th Cir. 1992). During the trial Mr. Petros, Ms. Richani and Mr. Rowland all testified that they remembered receiving the Financial Statement from Mr. Rego. However, none of them could state with any specificity whether the Financial Statement was received before or after Timber Ridge entered into the Lease with and advanced funds to Mr. Rego. Mr. Petros also testified that he never saw the version of the Financial Statement that included schedules. When asked what due diligence he conducted in determining whether to do business with Mr. Rego, Mr. Petros cited his knowledge of the Rego family's history in the grocery business, his visit to one of the Rego brothers' grocery stores located in Brunswick, Ohio and the Financial Statement. However, as already noted, Mr. Petros could not definitively say

whether or not the Financial Statement was delivered to Timber Ridge before he decided to let the anchor tenant grocery store space to Mr. Rego.

The only other evidence presented by Timber Ridge that it in any way relied upon the Financial Statement to decide to contract with Mr. Rego was a statement by Mr. Petros that he could not recall ever entering into a lease on behalf of Timber Ridge without first receiving a financial statement from a prospective tenant. Even if such self-serving statement were accepted as true, it, along with the other evidence presented, is not sufficient to prove that Timber Ridge in any way relied upon the Financial Statement when entering into the Lease with and advancing funds to Mr. Rego. Accordingly, Timber Ridge has failed to satisfy the third element of a cause of action under § 523(a)(2)(B).

The last element of a § 523(a)(2)(B) action requires proof that the Financial Statement was delivered to Timber Ridge by Mr. Rego with an intent to deceive. Because a debtor will rarely admit that he acted with an intent to deceive, such intent can be proven by inference from the totality of circumstances surrounding a debtor's acts. *Investors Credit Corp. v. Batie (In re Batie)*, 995 F.2d 85, 90 (6th Cir. 1993). Knowledge about the falsity of the information contained in a financial statement or a reckless disregard for its truth can satisfy the intent element of § 523(a)(2)(B).

During the trial, Mr. Rego's responses to questions about the accuracy of the information listed in the Financial Statement were vague and he claimed to be ignorant of basic information that he should have been familiar with especially given his background as a business owner. For instance, although he claimed not to know that the Trust contains a spendthrift provision, he was aware that he has no control over how the Trust assets are invested or how and when distributions from the Trust are made. He was also unable to explain why, despite his knowledge of and basic familiarity with the Separation Agreement, he did not list Judith Rego's 20% interest in his portion of the Trust on

the Financial Statement. Mr. Rego also failed to credibly explain why Schedule 4 of the Financial Statement contained no reference to the mortgage on the Columbia Road property or his obligation under the Separation Agreement to satisfy that mortgage and pay Judith Rego \$173,500 from the proceeds of any sale. The totality of the evidence presented on this issue was sufficient to show that the false representations on the Financial Statement were made by Mr. Rego with reckless indifference to actual facts which he should have known or which were readily available for him to obtain. Accordingly, Timber Ridge has satisfied the last element of a cause of action under § 523(a)(2)(B).

CONCLUSION

Based upon the foregoing the Court finds that, although Timber Ridge met its burden of proving the first, second and fourth elements of a cause of action under 11 U.S.C. § 523(a)(2)(B), it failed to prove the third element regarding reasonable reliance on the Financial Statement. Accordingly, the counts in complaint that are based upon § 523(a)(2)(B) of the Bankruptcy Code must fail. A final judgment consistent with this Memorandum Opinion will be entered separately.

#

cc (*via* electronic mail):

Diana Thimmig, counsel for plaintiff

T. Jeffrey Tumlin, counsel for defendant-debtor