UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
WESTERN DIVISION

In Re:	)	Case No.: 04-32258
	)	
James K. King,	)	Chapter 7
	)	
Debtor.	)	Adv. Pro. No. 04-3238
	)	
Commodore Perry Federal Credit Union,	)	Hon. Mary Ann Whipple
	)	
Plaintiff,	)	
v.	)	
	)	
James K. King,	)	
	)	
Defendant.	)	

MEMORANDUM OF DECISION AND ORDER REGARDING MOTION FOR SUMMARY JUDGMENT

Plaintiff Commodore Perry Federal Credit Union ("Plaintiff") filed a Motion for Summary Judgment in this proceeding on January 13, 2005 (the "Motion"). After reviewing the Motion, the affidavits and other exhibits in support of the Motion, and the opposing memorandum and affidavit filed by James K. King ("Defendant"), the court will grant the Motion.

The court has jurisdiction over this adversary proceeding under 28 U.S.C. § 1334(b) and the general order of reference entered in this district. Actions to determine dischargeability are core proceedings that this court may hear and decide. 28 U.S.C. § 157(b)(1) and (b)(2)(I).

FACTUAL AND PROCEDURAL BACKGROUND

Defendant is an experienced mechanic who is very knowledgeable about motor vehicles, and has restored in excess of 25 vehicles in recent years. (Am. Compl. to Determine Dischargeability of Debt ¶ 2 [hereinafter cited as Am. Compl.]; Answer to Am. Compl. of Commodore Perry Credit Union ¶ 1 [hereinafter cited as Am. Ans.].) On or about September 8, 2000, Plaintiff lent Defendant the sum of $6,750, the repayment of which was secured by a security interest in a certain 1970 Chevrolet half-ton truck

(the "Collateral") (Am. Compl. ¶ 3; Am. Ans. ¶ 1), which Defendant orally represented was totally restored and in excellent condition ((Aff. of Jean Daniels in Supp. of Pl.'s Mot.

for Summ. J. ¶ 7 [hereinafter cited as Daniels Aff.]; Aff. of Ralph Woessner in Supp. of Pl.'s Mot. for Summ. J. ¶ 7 [hereinafter cited as Woessner Aff.]; Aff. of Karen Gresh in Supp. of Pl.'s Mot. for Summ. J. ¶ 6 [hereinafter cited as First Gresh Aff.].) In fact, the Collateral had not been restored and its condition was far from "excellent." (Depo. of James K. King, at 14, 21-22, 26, 45-47 (taken Nov. 2, 2004) [hereinafter cited as King Depo.].) Plaintiff required an appraisal of the Collateral in connection with the loan, and Defendant provided an appraisal valuing the Collateral at $7,500 and indicating that the Collateral had been "totally restored" and was in "excellent condition." (Am. Compl. ¶¶ 4, 8; Am. Ans. ¶ 1.) Defendant represented orally to Plaintiff that the purchase price of the Collateral was $6,750, and that representation was reduced to writing in an application to the State of Ohio for issuance of a certificate of title, which Defendant signed. (Daniels Aff. ¶¶ 10, 11; Aff. of James K. King ¶ 5 [hereinafter cited as King Aff.]; Second Aff. of Karen Gresh in Supp. of Pl.'s Mot. for Summ. J. ¶¶ 8, 11 [hereinafter cited as Second Gresh Aff.]; Aff. of Dorsie Peterson in Supp. of Pl.'s Mot. for Summ. J. ¶¶ 7-8.) Defendant admitted in testimony in connection with this proceeding that the actual value and purchase price was $3,800, and that the loan proceeds in excess of that purchase price were given to a friend. (Am. Compl. ¶ 6; Am. Ans. ¶ 1; King Depo., at 15-16, 19, 23.)

In December 2001, Defendant applied for and obtained another loan from Plaintiff. (Daniels Aff. ¶ 6; Woessner Aff. ¶ 6; First Gresh Aff. ¶ 5.) The proceeds of the second loan were $10,000. (Daniels Aff. ¶ 7; Mot. for Summ. J. Ex. B.) The loan proceeds were used to satisfy the original loan and to make a new advance; again, repayment of the second loan was secured by a security interest in the Collateral. (Daniels Aff. ¶ ¶ 6, 11; Mot. for Summ. J. Ex. D.) Plaintiff relied on Defendant's representations regarding the value and condition of the Collateral and its purchase price in making both loans. (Daniels Aff. ¶¶ 9-12 Second Gresh Aff. ¶¶ 9, 10, 14.) No new representations were made in connection with this loan. No new appraisal of the Collateral was requested by Plaintiff or presented by Defendant.

Each of the security agreements contains the following paragraph:

> **USE OF PROPERTY** — Until the advance has been paid off, you promise you will: (1) Use the property carefully and keep it in good repair. (2) Obtain written permission from the credit union before making major changes to the property. (3) Inform the credit union in writing before changing your address or the address where the property is kept. (4) Allow the credit union to inspect the property. (5) Promptly notify the credit union if the property is damaged, stolen or abused. (6) Not use the property for any unlawful purpose.

Defendant did not use the Collateral carefully, keep it in good repair, obtain written permission before making major changes to the Collateral, or notify Plaintiff that the Collateral had been damaged, stolen, or abused. (King Depo., at 38, 40-42, 44.) Defendant admits that he drag raced the truck, eventually blowing the engine. (King Depo., at 17-18.) Thereafter, Defendant acknowledges that he dismantled the truck. (King Depo., at 36-38.)

On March 26, 2004, Defendant filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. Defendant's schedules of assets indicated that the Collateral had a value at filing of $1,000. He also testified in his deposition that the "as is" value of the truck was $1,000 to $1,500, evidence Plaintiff has not contested. On May 17, 2004, a Report of Trustee in No-Asset Case was filed in Defendant's Chapter 7 case. On May 18, 2004, Plaintiff inspected the Collateral and found that it had been dismantled (Woessner Aff. ¶ 8) and that some of the parts had been discarded or were missing. Defendant acknowledged to Plaintiff that the Collateral had been in running condition when he purchased it, that he had dismantled the Collateral, that he had blown up the engine through his own misuse of the Collateral, and that parts were missing. (Woessner Aff. ¶¶ 9-11; First Gresh Aff. ¶¶ 8-11.) Defendant explains that he disassembled the Collateral to replace parts. (King Aff. ¶ 3.) He has further admitted to Plaintiff that the appraiser he retained in September 2000 had not seen the Collateral, but had simply valued the Collateral at the amount Defendant told him to use. (Woessner Aff. ¶ 12; Gresh Aff ¶ 12; King Depo., at 15, 20-21.)

On July 12, 2004, Plaintiff filed the complaint initiating this adversary proceeding. With leave of court, Plaintiff filed an amended complaint on November 30, 2004. As indicated above, Plaintiff filed the Motion on January 13, 2005, along with the transcript of Defendant's deposition, affidavits of two of Plaintiff's employees, and other supporting documentation. Defendant filed his Memorandum in Opposition

to Motion for Summary Judgment on February 7, 2005, along with his affidavit, and Plaintiff filed a reply on February 16, 2005, along with two additional affidavits. The balance of the indebtedness was $8,957.43 as of January 13, 2005, and the debt accrues additional interest at a *per diem* rate of $3.42. (Daniels Aff. ¶ 13.)

LAW AND ANALYSIS

Plaintiff relies on § 523(a)(2) and (6) of the Bankruptcy Code in contending that Defendant's indebtedness is nondischargeable. The former statute provides, in pertinent part:

> A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud.

11 U.S.C. § 523(a)(2)(A). The Sixth Circuit has enumerated the elements under this provision as follows:

> In order to except a debt from discharge under § 523(a)(2)(A), a creditor must prove the following elements: (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 loss.

Rembert v. AT & T Universal Card Services, Inc. (In re Rembert), 141 F.3d 277, 280-81 (6th Cir. 1998). The party seeking the exception to discharge bears the burden of proof on each element of its claim by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 291 (1991).

The Sixth Circuit also held in *Rembert* that "[w]hether a debtor possessed an intent to defraud a creditor within the scope of § 523(a)(2)(A) is measured by a subjective standard." *Id.* at 281. However, "gross recklessness is sufficient to establish an intent to deceive." *Bank One, Lexington, N.A. v. Woolum (In re Woolum)*, 979 F.2d 71, 73 (6th Cir. 1992). "Because direct proof of intent, the Debtor's state of mind, is nearly impossible to obtain, the creditor may present evidence of the surrounding circumstances from which intent may be inferred." *ITT Fin. Serv. v. Long (In re Long)*, 124 B.R. 54, 56 (Bankr. N.D. Ohio 1991); *accord, e.g., Palmacci v. Umpierrez*, 121 F.3d 781, 789 (1st Cir. 1997) (quoting *Anastas v. Am. Sav. Bank (In re Anastas)*, 94 F.3d 1280, 1286 n.3 (9th Cir. 1996)); *Equitable Bank v. Miller*

(In re Miller), 39 F.3d 301, 305 (11th Cir. 1994); *First Nat'l Bank v. Kimzey (In re Kimzey)*, 761 F.2d 421, 424 (7th Cir. 1985); *Crawford v. Monfort (In re Monfort)*, 276 B.R. 793, 796 (Bankr. N.D. Ohio 2001); *Citibank v. Weaver (In re Weaver)*, 139 B.R. 677, 679 (Bankr. N.D. Ohio 1992); *see Alport v. Ritter (In re Alport)*, 144 F.3d 1163, 1167 (8th Cir. 1998).

As for the creditor's reliance, the Supreme Court has made clear that the reliance must be justified, but need not be reasonable. *Field v. Mans*, 516 U.S. 59, 74-75 (1995). The test is a subjective one rather than an objective one. *Id.* at 70-71. The pertinent question is thus whether the creditor was justified in relying on the representation, rather than whether a reasonable person would have done so. A creditor is not required to conduct an investigation as to the truth or falsity of the statement. *Id.* at 70.

The court finds that there is no genuine issue of material fact that Defendant obtained money from Plaintiff through material misrepresentations, which he knew were false. Specifically, Defendant does not deny that he represented to Plaintiff that the Collateral was totally restored and in excellent condition. (First Gresh Aff. ¶ 6.) This misrepresentation also indisputably appears in the written appraisal Defendant obtained and provided to Plaintiff, at its request, before it made the first loan to him. Defendant now admits that the truck had not been restored and was in poor condition and that a number of parts needed to be replaced. The appraisal also falsely stated that the value of the Collateral was $7,500, when Defendant now acknowledges that it was really worth only the $3,800 he actually paid for the truck the day he obtained the proceeds of the first loan. Defendant now admits that the appraiser simply reiterated in the appraisal the information that Defendant gave him, and that the appraiser never even looked at the truck. When the second loan was made, Defendant still failed to report the true value and condition of the truck, which was a material fact because the truck was also collateral for the second loan. The case law is well-settled that an omission to state or concealment of a material fact satisfies the material misrepresentation requirement of § 523(a)(2)(A). *Wings & Rings, Inc. v. Hoover (In re Hoover)*, 232 B.R. 695, 700 (Bankr. S.D. Ohio 1999) (failure to reveal sales tax liability to business purchaser a material misrepresentation); *see Metcalfe v. Waters (In re Waters)*, 239 B.R. 893, 901 (Bankr. W.D. Tenn. 1999).

Plaintiff also contends that Defendant misrepresented that the purchase price of the Collateral was $6,750, when the actual purchase price was only $3,800. Defendant argues that there is a genuine issue of material fact necessitating a trial on this point, so that the court may assess credibility of the witnesses involved. The basis for this argument is the statement in Defendant's affidavit that "When I applied for this initial loan, I told the credit union that I needed $6,750 to buy a truck. I did not represent this as the purchase price." Also, he states in his affidavit that Plaintiff prepared the title paperwork in which the purchase price was misrepresented as $6,750. Plaintiff's witnesses contradict Plaintiff's statement that he never represented the purchase price of the Collateral as $6,750, and Plaintiff argues in its reply brief, based on various documents and affidavits, that this is not a "credible" statement. The court cannot, of course, determine witness credibility in summary judgment proceedings.

To the extent it even exists, however, this conflict does not prevent summary judgment due to a genuine issue of material fact. For one reason, nothing in Defendant's testimony or affidavit contradicts the misrepresentation identified above about the value of the truck and its condition at the time Defendant purchased it. Quite simply stated, Defendant submitted a fake valuation to Plaintiff. For another reason, Defendant's affidavit statement hardly helps him out in light of his deposition testimony. He seeks to distinguish his alleged misrepresentation of the purchase price with the exceedingly subtle distinction that he instead told the credit union "he needed $6,750 to buy a truck." In fact, he did not "need" $6,750 to buy a truck, and knew so at the time the loan was extended. He needed $3,800 to buy the truck. In his deposition, Defendant describes getting the first loan check at the credit union, the truck seller's agent cashing it then and there and keeping $3,800, then giving the rest to Defendant. In turn Defendant says he gave the rest of the loan proceeds to a friend in need. Thus, Defendant's own affidavit scenario describes another materially false representation, even if it is not, as he argues, precisely the same one Plaintiff says he made.

Defendant's intent to deceive may be inferred from the fact that he knew his representations were false when made and that they would induce Plaintiff to make the loans. *See Coman v. Phillips (In re Phillips)*, 804 F.2d 930, 933-34 (6th Cir. 1986). Indeed, Defendant has testified that he only described

the Collateral as "totally restored" and in "excellent condition" because "that had to be on there to get the money." (King Depo., at 26.)

Plaintiff's affidavits show that loan officer Karen Gresh and general manager Jean Daniels relied on the misrepresentations in making both loans. The truck was Collateral for both loans. Defendant argues that there is a genuine issue of material fact on reliance, based again on two statements in his affidavit. First, he asserts in his memorandum in opposition that, in making the second loan, Karen Gresh was made aware of the truck's problems, so she could not have been relying on the false appraisal or the condition of the truck. But Defendant's affidavit says he made

Karen Gresh aware of the truck's problems in 2002. The second loan was made on December 12, 2001, before he says he even told her of the true condition of the truck. By that date, he had already drag raced the truck for at least one summer. Defendant's deposition testimony, given on November 2, 2004, is to the same effect, when he testified that "starting two years ago" he started telling her the truck was not in great shape. (King Depo., at 29-30.) Defendant has failed to create a genuine issue of material fact on reliance.

Second, Defendant asserts in his affidavit that "Karen Gresh told him he needed to get a 'piece of paper' indicating the value of the truck" and that "I [King] interpreted this requirement as a mere formality." (King Aff., ¶ 1.) The reliance standard is not applied from the objective point of view of the reasonable person. It is a subjective standard. Therefore, Defendant's interpretation of why Karen Gresh wanted the document is irrelevant to the question of whether reliance was justifiable. Moreover, to the extent this statement could be construed as casting a credibility shadow on whether the credit union actually relied on the appraisal, whether justifiably or otherwise, it does nothing to address reliance on his oral statements and omissions as to the true condition of the truck. Moreover, Plaintiff was justified in not requiring a new appraisal or an inspection of the Collateral or that Defendant confirm the condition of the Collateral when the second loan was made. This is because the second loan was made just 15 months after Plaintiff received the original information and the appraisal provided by Defendant. The Collateral was represented to the credit union as a classic restored vehicle, not as a routine vehicle of recent origin used for everyday

transportation the value of which decreases day by day. Therefore, there is no genuine issue of material fact as to Plaintiff's justifiable reliance on Defendant's misrepresentations and omissions.

Lastly, Plaintiff asserts that it sustained loss proximately caused by its reliance on Defendant's material misrepresentations and omissions, and that the loss is measured by the current loan balance of $8,957.43, plus other charges permitted under the loan agreement. Based on the undisputed facts shown by Plaintiff's affidavits, the court finds that Plaintiff has proven by a preponderance of the evidence the required element that its reliance was the proximate cause of a loss. The court does not agree, however, that the loss proximately caused by Plaintiff's reliance is the loan balance, which is essentially a contract damages measure. The statute states that debts are excepted from discharge under § 523(a)(2) only "to the extent obtained by" false misrepresentations. The

second loan proceeds were $10,000. They were not used to buy the truck, nor did Plaintiff think they were being used to buy the truck. Thus, when the second loan was made, even based on Defendant's misrepresentations, Plaintiff knew it was extending Defendant unsecured credit beyond the $7,500 value gleaned from the information it was provided about the Collateral. *Cf*. 11 U.S.C. § 506(a). The misrepresentations proven by a preponderance of the evidence were not generally as to Defendant's intent to repay when he incurred the debt or to Defendant's overall financial condition. Rather, they related very specifically to the Collateral. Had the Collateral been as represented to Plaintiff, it was worth $7,500. Therefore, the loss proximately caused by Defendant's misrepresentations about the Collateral is not the entire loan balance, but the $7,500 misrepresented value of the truck. And since the Collateral still has value of $1,000 according to the undisputed evidence in the record, to which value Plaintiff's lien still attaches and can be realized upon if it chooses to do so, this amount must be subtracted to ascertain the extent of Plaintiff's nondischargeable loss proximately caused by its reliance on Defendant's intentional misrepresentations and omissions.[1]

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[1] In making this determination of the "debt" to be excepted from Defendant's discharge , the court is carefully mindful of the Supreme Court's decision in *Cohen v. de la Cruz*, 523 U.S. 213 (1998). In *de la Cruz*, the bankruptcy court awarded plaintiffs a nondischargeable judgment under § 523(a)(2). The judgment included punitive damages, as well as treble damages, attorney's fees and costs under the New Jersey Consumer Fraud Act. The Supreme Court rejected the debtor/petitioner's argument that the treble (continued...)

Accordingly, the court finds that there is no genuine issue of fact that Defendant obtained money and an extension, renewal, or refinancing of credit by false pretenses, false representations, and actual fraud. Based on those undisputed facts, the court concludes that Plaintiff is entitled, as a matter of law, to a judgment that Defendant's indebtedness is nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A) in the amount of $6,500. Fed. R. Bankr. P. 7056; Fed. R. Civ. P. 56(c). In accordance with this memorandum of decision, the court will separately enter judgment in this amount, plus interest on the judgment at the current federal rate calculated under 28 U.S.C. § 1961(a) and costs in the form of the filing fee for this

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[1] (...continued)
damages, attorney's fees and costs parts of the judgment were dischargeable because they did not reflect money, property or services "obtained" by the debtor through fraud.

De la Cruz does not, however, obliterate the distinction between fraud damages and breach of contract damages. After *de la Cruz*, bankruptcy courts in § 523(a)(2) dischargeability actions have still carefully distinguished between nondischargeable fraud debts and dischargeable contract debts. *See, e.g., Sandak v. Dobrayel (In re Dobrayel)*, 287 B.R. 3, 24-25 (Bankr. S.D.N.Y. 2002) (carefully and thoroughly distinguishing between building contractor fraud and plain breach of contract in determining damages and dischargeability issues); *Novartis Corp. v. Luppino (In re Luppino)*, 221 B.R. 693, 703-04 (Bankr. S.D.N.Y. 1998) (analysis still required on each debt to determine whether it was proximately caused by § 523(a)(2)(A) acts). The court believes this is still the correct approach under *de la Cruz*, and has so applied it in reaching its decision.

Plaintiff essentially seeks in its prayer for relief damages based on breach of its loan contract. *De la Cruz* requires the court to focus on all damages proximately caused to the creditor by the wrongful act. In a state court action, Plaintiff could have asserted breach of contract *and* fraud claims against Defendant. In certain circumstances, punitive damages, *Logsdon v. Graham Ford Co.*, 54 Ohio St. 2d 336, 339-40 (1978); *Bennice v. Bennice*, 82 Ohio App. 3d 594, 599 (Ottawa Cty. 1992) (standard requires a finding that the fraud has been gross or malicious), and attorney's fees, *Galmish v. Cicchini*, 90 Ohio St. 3d 22, 35 (2000) (attorney's fees are only appropriately awarded under Ohio law on a fraud claim where punitive damages are warranted), may be awarded under Ohio law on fraud claims. Plaintiff has neither requested nor shown any entitlement to punitive damages. But if it had been awarded such damages under state law, or if it pleaded and proved such damages in this court, *de la Cruz* would mandate that they be excepted from Defendant's discharge. On the other hand, simple breach of contract debts, such as Defendant's failure to repay the second loan and other charges in accordance with its terms, are not excepted from discharge under § 523(a)(2). As the Supreme Court observed in *de la Cruz*, fraud damages may sometimes exceed contract damages. *de la Cruz*, 523 U.S. at 222-23.

action. *See Longo v. McLaren (In re McLaren)*, 3 F.3d 958, 965 (6th Cir. 1993) (bankruptcy courts generally have the power to enter money judgments in dischargeability actions).

The court finds that it is unnecessary to address Plaintiff's claim under § 523(a)(6) relating to willful and malicious injury to the Collateral in which Plaintiff has a lien.[2]

[2] The factual basis for the § 523(a)(6) claim is Defendant's misuse and abuse of Plaintiff's Collateral. The maximum damages under this claim would still not amount to the total contract loan balance, as the actual damage to and reduction in the value of the Collateral shown on the record is from $3,800 to the $1,000 current value. Alternative pleading is permitted. But Plaintiff cannot ultimately prevail on both a claim factually premised on the value and condition of the Collateral having been misrepresented in the first place and a claim for its destruction based on a false value. As noted by a leading treatise, "[c]ourts must be careful not to equate a breach of contract, which happens to be a security agreement, with conduct causing willful and malicious injury." L. King, ed., *Collier on Bankruptcy* ¶ 523.12[3] at p. 523-95 (15th ed. rev.).

THEREFORE, for the foregoing reasons,

IT IS ORDERED that Plaintiff's Motion for Summary Judgment [Doc. #19] is granted in part and denied in part.

Mary Ann Whipple
United States Bankruptcy Judge