EXCEPTIONS TO DISCHARGE IN CHAPTER 7

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Section 523 of the Bankruptcy Code addresses the exceptions to an individual debtor's discharge under Section 727 of the Code. Whether or not a particular debt meets the listed non-dischargeable debts in Section 523 (a) may require a Court determination, and either a debtor or a creditor may file a complaint to obtain that determination. Bankruptcy Rule 4007(a).

Deadline for Filing Dischargeability Actions

Section 523(c) creates two categories of non-dischargeability of debts – the first category includes debts described in Sections 523 (a)(2), (4), and (6), for which the debtor timely listed the debts under Section 521(1) to permit those creditors to file proofs of claim or to timely file non-dischargeability actions. See Section 523 (c) (3)(A) and (B). Sections 523(a)(2), (4), and (6) reference general fraud debts, fraud in a fiduciary capacity, or willful and malicious injury to an entity or property of an entity. An "entity" is defined in the Code as a person, estate, trust, governmental unit, and U.S. Trustee. Section 101(15). The second category of debts is all the remaining debts listed in Section 523(a).

The first category of debts requires a complaint to determine the dischargeability of the debt to be filed no later than 60 days after the first date set for the meeting of creditors under Section 341(a). Bankruptcy Rule 4007(c). The Court is required to send all creditors no less than 30 days notice of time restrictions for filing the complaints by notice as set forth in Rule 2002. Creditors may, for cause, request an extension of time to file a complaint, although they must make the request for extension prior to the expiration of the time period described above. It is important to note that the deadline runs from the date the first meeting under Section 341(a) is

scheduled, whether or not the meeting actually takes place on that date. See _In re Anwiler_, 115 B.R. 661 (B.A.P. 9th Cir. 1990), *aff'd* 958 F.2d 925 (9th Cir.), *cert. denied* 506 U.S. 882 (1992).

A complaint under Section 523(a) may be filed regarding the second category of debts at any time. Bankruptcy Rule 4007(b). If the debtor or a creditor requests that a bankruptcy case be reopened to determine dischargeability of this second category of debts after the case has been closed, the case is reopened without payment of an additional filing fee for the purpose of filing the complaint.

Elements of Dischargeability Actions and Defenses

Creditors must prove that a debt is non-dischargeable by a preponderance of the evidence. _Grogan v. Garner_, 498 U.S. 279 (1991). The exceptions to discharge are strictly construed in favor of dischargeability. _In re Hudson_, 107 F.3d 355 (5th Cir. 1997). Collateral estoppel principles apply in dischargeability proceedings. _Grogan v. Gardner_, supra.

Section 523(a)(6)

Section 523(a)(6) reads as follows:

> **(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—
> **(6)** for willful and malicious injury by the debtor to another entity or to the
>
> property of another entity;

As noted earlier, an "entity" is broadly defined under the Code. The word "person" is also broadly defined under the Code to include an individual, partnership, or corporation, and in some instances, governmental units. As a result, any willful or malicious injury by a debtor to almost any creditor, or property of a creditor, may be determined non-dischargeable. The key words are "willful and malicious" (emphasis added). A recent case analyzing Section 523(a)(6) is helpful in understanding when a debtor's actions meet the "willful and malicious" standard, In re Brown, 11-6008, 2012 WL 2989236 (6th Cir. July 23, 2012). Squibs from that case follow:

Synopsis

Background: Bankruptcy court issued summary judgment in favor of debtor on claim by judgment creditors that underlying judgment had been based on willful and malicious injury by debtor. Creditors appealed. The United States District Court for the Eastern District of Kentucky affirmed. Creditors appealed.

Holdings: The Court of Appeals, Helene N. White, Circuit Judge, held that:

1 identity of issues requirement had not been met, and thus collateral estoppel doctrine did not apply and

2 negligence was insufficient to satisfy intent requirement on discharge exception claim.

Affirmed

In re Brown, 11-6008, 2012 WL 2989236 (6th Cir. July 23, 2012)

We disagree. Under the tree piracy statute, the state court was required to consider whether Brown acted with an "intent to convert to his own use timber growing upon the land of another." Ky. Rev. Stat. § 364.130. In contrast, the bankruptcy court, in order to find "willful and malicious injury," was required to determine whether Brown "(1) intended to cause injury to the Creditor or to the Creditor's property, or (2) engaged in an intentional act from which [Brown] believed injury would be substantially certain to result." *In re Sweeney,* 264 B.R. 866, 871 (Bankr. W.D. Ky. 2001) (citing *Markowitz v. Campbell (In re Markowitz),* 190 F.3d 455, 464 (6th Cir. 1999)); *see also Kennedy v. Mustaine (In re Kennedy),* 249 F.3d 576, 579–80 (6th Cir. 2001); *Kawaauhau v. Geiger,* 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed. 2d 90 (1998) (holding that, with respect to the intent requirement under § 523(a)(6), "[t]he section's word 'willful' modifies the word 'injury,' indicating that nondischargeability takes a deliberate or intentional *injury,* not merely a deliberate or intentional *act* that leads to injury.").

Thus, because the state court found merely an intent to convert timber belonging to Gatliff, rather than an intent to injure Morris and Lynch, Morris and Lynch cannot establish identity of issues. Accordingly, we decline to give the state court default judgments preclusive effect as to the "willful and malicious injury" requirement of the § 523(a)(6) discharge exception.

In re Brown, 11-6008, 2012 WL 2989236 (6th Cir. July 23, 2012)

Neither Brown's failure to obtain general liability insurance, nor his failure to provide notice to or obtain an agreement from Gatliff, creates a genuine dispute as to whether Brown committed a willful and malicious injury against Morris and Lynch. At most, Brown's liability with respect to Morris and Lynch is grounded in negligence, which is insufficient to satisfy the intent requirement under

§523(a)(6). We agree with the bankruptcy court that Morris and Lynch provide no further evidence "that Brown desired, intended, or was substantially certain that [Morris and Lynch] would be subjected to a monetary judgment ... if he timbered the property." (Bankruptcy Ct. Opinion, Appx. at 139–40.) Thus, the bankruptcy court did not err in declining to apply the § 523(a)(6) exception to discharge and granting Brown's motion for summary judgment.
In re Brown, 11-6008, 2012 WL 2989236 (6th Cir. July 23, 2012)

Section 523 (a)(2)(A)

Section 523(a)(2)(A) prohibits the discharge of any debt to the extent obtained by false pretenses, a false representation, or actual fraud and reads as follows:

(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 a statement respecting the debtor's or an insider's financial condition;

(C)

(i) for purposes of subparagraph (A)—

(I) consumer debts owed to a single creditor and aggregating more than $600 for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief under this title are presumed to be nondischargeable; and

(II) cash advances aggregating more than $875 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable; and

(ii) for purposes of this subparagraph—

(I) the terms "consumer", "credit", and "open end credit plan" have the same meanings as in section 103 of the Truth in Lending Act; and

(II) the term "luxury goods or services" does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor;

Proving fraud under this section requires the usual demonstration of an intentional misrepresentation of a material fact, upon which a creditor relies to his or her detriment. The standard of reliance is justifiable, rather than reasonable. Reasonable reliance looks to a

reasonable person standard, while justifiable reliance looks at the sophistication and circumstances of the actual creditor. See *Field v. Mans*, 515 U.S. 59 (1995). Intent of the debtor is the critical element of proof. Three recent cases illustrate circumstances where Courts will determine a debt non-dischargeable, as in the following squibs from *In re Kapetanakis*, *In re Deitz*, and *Stelmokas v. Kodzius*:

> **Synopsis**
>
> **Background:** Chapter 7 debtor, who was indemnitor on surety bonds issued for his corporation's obligations, sought discharge of consent-judgment debt owed to defrauded issuer of bonds. The Bankruptcy Court, Marvin Isgur, Bankruptcy Judge, 2010 WL 1463437, ruled that debt was nondischargeable, and the United States District Court for the Southern District of Texas affirmed. Debtor appealed.
>
> **Holding:** The Court of Appeals held that debt was nondischargeable.
> Affirmed.
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> In re Kapetanakis, 478 F. App'x 217 (5th Cir. 2012)
>
> PER CURIAM:[*]
>
> Defendant–Appellant Leonidas Kapetanakis ("Kapetanakis") appeals the bankruptcy court's ruling, as affirmed by the ***218** district court, that, pursuant to 11 U.S.C. § 523(a)(2)(A), a claim by Plaintiff–Appellee First National Insurance Company of America ("First National") against Kapetanakis as indemnitor of his corporation's obligations is not dischargeable in bankruptcy. Both the district court and the bankruptcy court held that the $3,050,000.00 debt, which Kapetanakis had incurred as indemnitor, was not dischargeable because he had obtained surety bonds for his corporation from First National through actual fraud. Specifically, Kapetanakis had not only signed for himself but had forged the signatures of his spouse, his brother, and his brother's spouse, as indemnitors under an agreement (the "Indemnity Agreement") that First National had required before issuing the bonds in question to the closely held Kapetanakis corporation, Quality Woodwork Interiors, Inc.
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> In re Kapetanakis, 478 F. App'x 217 (5th Cir. 2012)
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> The record as a whole supports the determination that First National actually and justifiably relied on the Indemnity Agreement in issuing the bonds that gave rise to the debt in question, and that Kapetanakis intended to deceive First National when he forged the signatures of the other putative indemnitors. And, it is well established that a settlement agreement of a non-dischargeable obligation does not convert the debt to one that is dischargeable.[2]

For the foregoing reasons, the holding that Kapetanakis's consent judgment in favor of First National is non-dischargeable in bankruptcy is AFFIRMED.

In re Kapetanakis, 478 F. App'x 217, 219 n.2 (5th Cir. 2012) (citing Archer V. Warner, 538 U.S. 314, 321, 123 S.Ct. 1462, 155 L.Ed.2d 454 (2003).

Synopsis

Background: Order was entered by the United States Bankruptcy Court for the Eastern District of California, Richard T. Ford, J., awarding money damages to homebuyers based on fraudulent statements allegedly made by Chapter 7 debtor-contractor to induce them to enter into contract with him for construction of home and declaring that debt was nondischargeable in bankruptcy. Debtor appealed.

Holdings: The Bankruptcy Appellate Panel, Pappas, J., held that:

1 bankruptcy court had authority, not only to finally adjudicate dischargeability of Chapter 7 debtor's obligation to homebuyers for whom he had agreed to construct home, but to liquidate amount of that nondischargeable debt;

2 bankruptcy court did not clearly err in finding that debtor-contractor had acted with intent to deceive in falsely representing to prospective clients who were interested in hiring him to build home that he was licensed general contractor in good standing; and

3 court did not clearly err in finding that homebuyers had justifiably relied on debtor's representations, as required by fraud-based dischargeability exception. Affirmed.

In re Deitz, 469 B.R. 11 (B.A.P. 9th Cir. 2012)

That a contractor was properly licensed was important to the Fords because it was a condition for their receipt of funds from the VA. The court clearly found that Deitz was not licensed at the time of executing the contract. Additionally, the evidence showed that Deitz' contractor license had been suspended six times, and was finally revoked, during his construction of the Fords' house. The court had testimonial evidence from Ford and Thompson, as well as documentary evidence, that Deitz had made misrepresentations regarding his license and skills to several other parties by which he had induced them to enter into construction contracts that, like the Ford case, had failed. Evidence of the habit of a person, or of a routine or practice, is relevant to prove that the conduct of a person on a particular occasion was in conformity with their habit or routine practice. Fed.R.Evid. 406. The bankruptcy court also determined that Deitz misrepresented to the Fords that he would complete the construction of the home according to ADA, VA and county standards.

In re Deitz, 469 B.R. 11, 24 (B.A.P. 9th Cir. 2012)

Synopsis

Background: Creditor filed adversary action against debtor in bankruptcy seeking to prevent discharge of debt. The bankruptcy court found in favor of debtor and awarded attorney fees to debtor. Creditor appealed. The United States District Court for the Northern District of Illinois, Amy J. St. Eve, J., 2011 WL 4047304, affirmed. Creditor appealed.

Holdings: The Court of Appeals held that:

1 debtor's verbal statement that he would not have any trouble repaying promissory note was one concerning his overall financial health;

2 creditor did not waive or forfeit argument in adversary proceeding below;

3 creditor staved off waiver or forfeiture of his argument on appeal; and

4 award of attorney fees against creditor was improper.

Affirmed in part and reversed in part.

Stelmokas v. Kodzius, 460 F. App'x 600 (7th Cir. 2012)

Stelmokas appealed to the district court, which upheld the decisions on both his adversary complaint and the award of attorney's fees. In this court he maintains again that because Kodzius's oral assurances that he could repay the loan were “unconditional and unequivocal” they should be regarded as misrepresentations under § 523(a)(2)(A). But that contention misses the point. Section 523(a)(2)(A) provides that even a debtor who induces a debt through misrepresentation has an escape hatch: The debt is still dischargeable if the claim of false pretenses, false representation, or actual fraud rests on “a statement respecting the debtor's ... financial condition.” *In re Joelson,* 427 F.3d 700, 705 (10th Cir. 2005); *In re Bogdanovich,* 292 F.3d 104, 112–13 (2d Cir. 2002); *In re Kosinski,* 424 B.R. 599, 607–08 (B.A.P. 1st Cir. 2010). That is the situation here.

Stelmokas v. Kodzius, 460 F. App'x 600, 603 (7th Cir. 2012)

The few appellate decisions on point have taken different approaches in defining what constitutes a statement respecting the debtor's financial condition. The narrow view is that the statement must paint a picture about the debtor's *overall* financial health, while the broad view encompasses statements of that nature

> along with any other that conveys significant information about the debtor's finances. See *In re Joelson,* 427 F.3d at 705 (narrow view); *In re Bogdanovich,* 292 F.3d at 112 ***604** (noting inconsistent views but declining to choose); *Engler v. Van Steinburg (In re Van Steinburg),* 744 F.2d 1060, 1061 (4th Cir. 1984) (broad view). We have not yet addressed the question, although we note that a majority of bankruptcy courts in this circuit have opted for the narrow construction. Compare *In re Cassel,* 322 B.R. 363, 374–75 (Bankr. C.D. Ill. 2005) (narrow); *In re Olinger,* 160 B.R. 1004, 1009 (Bankr. S.D. Ind. 1993) (narrow); *In re Price,* 123 B.R. 42, 45 (Bankr. N.D. Ill. 1991) (narrow), with *In re Rhodes,* 93 B.R. 622, 624 (Bankr. S.D. Ill. 1988) (broad). But we need not resolve the question here, because neither construction helps Stelmokas, who bore the burden of proof on this issue. See *In re Cohen,* 507 F.3d 610, 613 (7th Cir. 2007). The only evidence of misrepresentation he introduced was Kodzius's statement that he would not have any trouble repaying the promissory note. Even assuming that Kodzius believed otherwise—he was, after all, weeks away from a foreclosure action—his representation still was one concerning his "overall financial health." Stelmokas also observes that Kodzius's continued use of his check-cashing services for V & V Construction after executing the promissory note shows that Kodzius had access to money that could have been used to repay the loan. The fact that no payments were made during the period when those checks were cashed, Stelmokas insists, demonstrates that Kodzius intended from the start to defraud him. See 4 Collier on Bankruptcy ¶ 523.08.[1][d], at 46 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) (explaining that debtor's failure "to take any steps to perform" contractual duties may create inference assurances of intent to perform were misrepresentations). But the promissory note did not obligate Kodzius to pay in installments, and, in any event, Stelmokas cannot use circumstantial evidence to demonstrate Kodzius's intent to defraud if he cannot prove any fraudulent act by Kodzius. And Stelmokas has not identified any false statement or misrepresentation made by Kodzius that is not exempted by the escape clause of § 523(a).

Stelmokas v. Kodzius, 460 F. App'x 600, 603-04 (7th Cir. 2012)

It is important for creditors to note that requesting a determination of dischargeability of a consumer debt under Section 523(a)(2) can lead to the imposition of costs and attorneys' fees against the creditor--if the debt is discharged and if the Court finds the position of the creditor was not substantially justified, the Court shall grant judgment to the debtor for costs and a reasonable attorneys fee. The Court shall not award those costs and fees if special circumstances would make the award unjust. Section 523(d). A "consumer debt" is defined in Section 101(8) as a debt that is incurred by an individual primarily for a personal, family, or household purpose.

Section 523(a)(2)(B)

Section 523(a)(2)(B) addresses fraud by a debtor that makes use of a statement in writing. Section 523(a)(2)(B) reads as follows:

> **(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—
>
> **(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.

Each of the elements of this section must be met for a determination of non-dischargeability. Minor inaccuracies in a written financial statement will not suffice, and a statement in writing that doesn't describe the debtor's financial circumstances will not result in non-dischargeability. Reasonable reliance, rather than justifiable reliance, is the necessary reliance standard. Finally, the debtor must "make" or publish the document with an intent to deceive the creditor. Two recent cases which demonstrate proof of these elements are *Tru Choice Credit Union v. O'Donnell*, Adv. Proceeding 11-20198 (Bankr. Me. 2012) and *Toye v. O'Donnell*, both of which were decided in the Maine Bankruptcy Court. The *Toye* First Circuit B.A.P. decision is attached to these materials.

The *Tru Choice Credit Union* case involved Debtor O'Donnell obtaining a loan from a credit union to make improvements to a multi-family residential building in Portland, Maine. The credit union asserted that O'Donnell obtained the loan by fraud because of the many inaccuracies in O'Donnell's financial statement, including a statement that O'Donnell occupied the building, even though the credit union claimed it later learned that O'Donnell did not live there. The credit union had a variety of other inaccurate O'Donnell financial statements admitted into evidence to support its position. O'Donnell had a witness to verify that he lived at the building at the time he obtained the loan. As a result, the Court concluded that the many inaccuracies in the financial statement did not rise to the level of material false representations. The Court also found that the credit union could not have relied at all in the financial statement,

given its lax lending practices, thereby failing to prove "reasonable reliance". The Court granted judgment for O'Donnell.

The *Toye* case involved the same debtor who owed approximately $500,000 to Toye on the purchase of a number of multi-unit residential properties in Portland, Maine. Toye was a hard money lender who expected his loan to be repaid within a short time – 6 months. The interesting feature of this case is that O'Donnell never saw, approved, made, or signed the financial statement upon which Toye relied. The Court found that O'Donnell's agent submitted the financial statement to Toye, and thereby O'Donnell was responsible for its contents, even though O'Donnell asserted that he didn't know it was being submitted. The case was appealed to the B.A.P., which affirmed the Bankruptcy Court. The case is now on appeal to the First Circuit Court of Appeals.

Section 523(a)(4)

Section 523(a)(4) of the Code prohibits discharge of fiduciary fraud debts:

(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—

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

This section describes four types of fraud, with defalcation representing a diversion, misuse , or misappropriation of funds by a debtor with recklessness (such as a very bad investment choice), a lesser standard of intention than required in proving fraud. A recent case illustrating proof of Section 523(a)(4) is *In re Kalinowski,* squibs of which follow:

Synopsis

Background: Landowner that retained construction company, organized as limited liability company (LLC), to build three residences brought adversary proceedings in separate bankruptcy cases of LLC's purported managers/operators, seeking determination that debts related to construction project were excepted from discharge based on debtors' defalcation while acting in fiduciary capacity. Adversary proceedings were consolidated, and parties cross-moved for partial summary judgment. The United States Bankruptcy Court for the District of New Mexico, Robert H. Jacobvitz, J., 449 B.R. 797, granted landowner's motion, and debtor appealed.

Holding: The Bankruptcy Appellate Panel, Thurman, Chief Judge, held that debtor, as de facto manager of LLC, stood in "fiduciary" relationship to landowner with respect to funds advanced for construction of homes, for debt dischargeability purposes.

Affirmed.

In re Kalinowski, 482 B.R. 334 (B.A.P. 10th Cir. 2012)

Thus, officers, directors, and shareholders of a corporation are routinely held responsible for the corporation's liabilities where they "participated" in the corporation's wrongful conduct. An analysis of the following decisions assists this Court in reviewing the personal liability of William here. First, the appeal of another bankruptcy ***341** court case is illustrative. In *In re Failing,*[25] the debtor owned an incorporated lending company that had contracted with the plaintiff for the exclusive right to obtain financing on its behalf. Pursuant to the contract, the plaintiff paid a $30,000 deposit, which the corporation agreed to keep in trust. Instead, the plaintiff's money was placed in the corporation's general account.

When no loan commitment was forthcoming, plaintiff requested that its deposit be returned. Despite repeated demands, the money was not returned, and plaintiff filed a state court action against both the corporation and the debtor, who then filed for bankruptcy relief. Plaintiff filed an adversary proceeding in the personal bankruptcy case relying, in part, on § 523(a)(4). The bankruptcy court found that the parties had created an express trust and that the plaintiff had been "cheated" out of its money by the corporation. However, it denied plaintiff's nondischargeability claim against the company's owner on the ground that plaintiff had failed to establish grounds to "pierce the corporate veil," which it held were necessary to hold the debtor personally responsible.

On appeal, the bankruptcy court's reasoning was determined to be erroneous: Upon review of the record and the applicable law, the court finds that the bankruptcy court erred in concluding that [debtor] could not be held personally liable such that the exception to discharge set forth in 11 U.S.C. § 523(a)(4) did not apply.

In re Kalinowski, 482 B.R. 334, 340-41 (B.A.P. 10th Cir. 2012)

In concluding that William was acting in a fiduciary capacity with respect to Hawks, the bankruptcy court reasoned that "[w]hen an individual undertakes the duties of a trustee with regard to an express or technical trust, he is, in fact acting in a fiduciary capacity with respect to the beneficiaries of that trust."[37] We agree. 89 A person who exercises the powers and duties of an office under color of right is a *de facto* officer, even if ineligible to hold that office.[38] It is clear from the undisputed facts that William was a *de facto* manager of K2, and therefore subject to the same principles of law as a legal manager, such as Karen, would be. These principles include the following:

Corporate officers are liable for their torts, although committed when acting officially, even though the acts were performed for the benefit of the corporation

and without profit to the officer personally.... The plaintiff must show some form of participation by the officer in the tort, or at least show that the officer ***344** directed, controlled, approved, or ratified the decision that led to the plaintiff's injury.
...
Personal liability for the torts of officers does not depend on the same grounds as "piercing the corporate veil".... The true basis of liability is the officer's violation of some duty owed to a third person that injures such third person.

These rules have been applied to principals of a limited liability company.[39]
In holding that William subjected himself to liability for defalcation of K2's fiduciary duties to Hawks, we are mindful of the long-standing admonition that this particular discharge exception must be very narrowly construed. However, we do not view this decision as broadening the exception.

In re Kalinowski, 482 B.R. 334, 343-44 (B.A.P. 10th Cir. 2012)

Sections 523 (a)(5) and (a)(15)

Sections 523(a)(5) and (a)(15) frequently arise in Chapter 7 cases. It is clear that domestic support obligations and property settlements are non-dischargeable in Chapter 7. Those sections and the definition of a "domestic support obligation" (Section 101(14A))follow:

(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—
5) for a domestic support obligation;
(15) to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit;
(14A) The term "domestic support obligation" means a debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is—
(A) owed to or recoverable by—
(i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or
(ii) a governmental unit;
(B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;

> **(C)** established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of—
>
> > **(i)** a separation agreement, divorce decree, or property settlement agreement;
> > **(ii)** an order of a court of record; or
> > **(iii)** a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and
>
> **(D)** not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

The definition of a creditor who is owed a "DSO" is a relatively narrow group. Grandparents are not on the list of protected creditors, nor are aunts or uncles, unless they are determined to be legal guardians or "responsible relatives". In the same way, same-sex couples who are not legally married may not have a DSO claim. Depending upon the Supreme Court's decisions on several DOMA cases before it, the Bankruptcy Courts may not be able to label certain debts as DSOs even if the same-sex couple resides in a state which permits same-sex marriage. The problem is further complicated by same-sex married couples who move to a state not recognizing the marriage – are claims between them DSOs or property settlement claims or not?

Most 523(a)(5) vs. (a)(15) disputes play out in Chapter 13 cases. 523(a)(15) debts are dischargeable in Chapter 13 (see Section 1328(a)(2)). Consequently, if a debtor has domestic relations debts which may possibly be determined to be 523(a)(15) debts, the debtor is usually encouraged to file a Chapter 13.

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NO. EP 12-015

Bankruptcy Case No. 11-20198-JBH
Adversary Proceeding No. 11-02034-JBH

DAVID O'DONNELL,
Debtor.

THOMAS A. TOYE, III,
Plaintiff-Appellee,

v.

DAVID O'DONNELL,
Defendant-Appellant.

Appeal from the United States Bankruptcy Court
for the District of Maine
(Hon. James B. Haines, Jr., U.S. Bankruptcy Judge)

Before
Lamoutte, Feeney, and Cabán,
United States Bankruptcy Appellate Panel Judges.

James F. Molleur, Esq., on brief for Appellant.
Kelly W. McDonald, Esq., on brief for Appellee.

December 5, 2012

Case: 12-15 Document: 20 Page: 2 Date Filed: 12/05/2012 Entry ID: 21...15

Per Curiam.

David O'Donnell ("O'Donnell") appeals from a bankruptcy court judgment in favor of Thomas A. Toye III ("Toye") determining that O'Donnell's obligation to Toye was nondischargeable pursuant to § 523(a)(2)(B)[1] because the extension of credit was obtained by use of a false financial statement. On appeal, O'Donnell argues that the bankruptcy court clearly erred in finding that he caused his personal financial statement "to be made or published with intent to deceive" Toye, as required by § 523(a)(2)(B)(iv). For the reasons set forth below, we **AFFIRM**.

BACKGROUND

In 2007, O'Donnell and Rudy Ferrante ("Ferrante") established Alder Street Properties, LLC for the purpose of acquiring and holding certain apartment buildings on Alder Street and Cumberland Avenue in Portland, Maine (the "Alder Street transaction"). Under the purchase agreement for the properties, O'Donnell and Ferrante were required to provide a $350,000.00 down payment at closing, and they asked Kevin Smith, a commercial loan broker, to help arrange the financing for a bridge loan (the "Loan"). Smith, who had assisted O'Donnell and Ferrante in several prior transactions, approached Toye to see if he would be interested in financing the Loan. Smith and Toye had also worked together on several prior transactions. In connection with the Loan, Smith prepared personal financial statements for O'Donnell and Ferrante and sent them to Toye. The document purporting to be O'Donnell's personal financial statement (the "Financial Statement") was dated December 3, 2007, and was signed with

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[1] Unless expressly stated otherwise, all references to "Bankruptcy Code" or to specific statutory sections shall be to the Bankruptcy Reform Act of 1978, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23, 11 U.S.C. §§ 101, et seq.

O'Donnell's name, although O'Donnell maintains that he did not sign it himself, and the evidence did not show otherwise. It indicated that O'Donnell had a net worth of $2,570,733.00, that his ownership in real estate (owned either individually or through LLCs) was valued at approximately $1,620,000.00, and that he had monthly income of $38,265.00. It is undisputed that the Financial Statement was a materially false statement of his financial condition as it overstated property ownership and net rental income, and did not include encumbrances on various properties.

After receiving the Financial Statement, Toye agreed to extend the Loan. In connection therewith, Alder Street Properties LLC executed a promissory note in the amount of $350,000.00, and both O'Donnell and Ferrante provided personal guaranties of the note. As additional security, O'Donnell executed a mortgage and security agreement with respect to certain real property in Augusta, Maine. The goal was to refinance within a few months and pay off the Loan. The refinancing never occurred, however, and Toye was never repaid.

Toye sued O'Donnell in the Kennebec County Superior Court for the debt due under his personal guaranty, and on August 27, 2009, the state court entered judgment against O'Donnell in the amount of $417,974.00.

In July 2009, Ferrante filed a chapter 7 petition, and Toye brought an adversary action against Ferrante seeking a determination that the debt owed to him on account of his personal guaranty was nondischargeable pursuant to § 523(a)(2)(B). After a trial, the bankruptcy court determined that Ferrante had provided Toye with a false financial statement within the meaning of § 523(a)(2)(B) on which Toye reasonably relied and, as a result, declared Ferrante's debt to Toye to be excepted from discharge.

O'Donnell filed a chapter 7 petition in February 2011. Thereafter, Toye filed a two-count adversary complaint alleging: (1) that O'Donnell's debt to him was nondischargeable pursuant to § 523(a)(2)(B) because the debt was obtained by use of a false financial statement; and (2) that Ferrante's fraud on Toye (as determined by the bankruptcy court in Ferrante's bankruptcy case) should be imputed to his partner, O'Donnell, for purposes of determining the dischargeability of O'Donnell's debt under § 523(a)(2)(B).

In a Joint Pre-Trial Memorandum, the parties indicated that there was no dispute that the Financial Statement was materially false, that it purported to relay O'Donnell's financial condition, or that Toye relied on it in extending the Loan. Rather, the primary factual dispute centered on the fourth prong under § 523(a)(2)(B) – whether O'Donnell caused the Financial Statement to be made or published with the intent to deceive Toye. O'Donnell also challenged whether Toye's reliance on the Financial Statement was justified, and whether Smith was Toye's agent in connection with the Loan. As to the imputation of fraud claim, the parties indicated that the primary factual dispute was whether O'Donnell and Ferrante were partners.

On March 8, 2012, the bankruptcy court held a trial at which Toye, Smith, and O'Donnell testified and numerous exhibits were introduced into evidence. O'Donnell testified that Smith had handled the financing for numerous prior transactions for O'Donnell and Ferrante, and that in connection with those transactions, Smith had prepared personal financial statements for O'Donnell and submitted them to the lenders on his behalf. With respect to the Alder Street transaction, O'Donnell testified that he knew Smith needed specific financial information from him, and he provided Smith with certain bank statements, tax returns, his social security number,

and records regarding his stock portfolio and retirement accounts. He insisted, however, that he did not provide any false information to Smith, and did not know the details of any financial statement that Smith was preparing to give to Toye with respect to the Alder Street transaction. According to O'Donnell, Smith never met with him to review the Financial Statement, and the first time he saw the Financial Statement was at a state court hearing after Toye obtained judgment against him. O'Donnell also asserted that although the Financial Statement was signed with his name, he did not sign the Financial Statement himself, and he did not know who signed it. Specifically, O'Donnell testified as follows:

> Q: And what was your understanding as to the extent to which you would have to give information to Kevin Smith that he could forward to Mr. Toye about your personal financial circumstances?
>
> A. Kevin – Kevin Smith told me that to, you know, to give Tom some – a sense of security and, you know, because Tom had never met me. I don't know if he'd ever met Rudy but he never met me. He needed some documents like my PrimeVest account, my retirement accounts, my stock, you know, stock – stock accounts and my Social Security Number and some tax returns.
>
> . . .
>
> Q: All right. So Kevin asked you for tax returns, he asked you for financial records.
>
> A. Yes.
>
> Q: And your Social Security Number so he could check out your credit.
>
> A. Yes.
>
> . . .
>
> Q: Did you understand that Kevin was creating a personal financial statement that would include all the real estate that you owned and monthly income and expenses for your buildings?
>
> A. Jim, I honestly didn't know what kind of financial statement he was putting together. I didn't know what it – he just told me what I needed to bring to get to them so I got that information that he required to him.

Q: And you had – you had actually sat down with Kevin Smith and prepared a personal financial statement back in June of 2007, about six months before.

A. Yes. Yup.

Smith testified about his business relationship with O'Donnell and Ferrante, and how he had assisted them with several prior transactions by preparing financial statements and other documentation. With respect to the Alder Street transaction, Smith testified about how the Loan was structured and what information he relied upon when preparing the Financial Statement. According to Smith, he gathered certain information from O'Donnell's tax returns, bank account statements, and investment account statements. He obtained income information from rent rolls or tax returns. Real estate ownership, valuations, and mortgages came from various sources, such as credit reports, city assessment records, Rudy Ferrante, or Chris Smith (a property manager assisting Ferrante and O'Donnell). Although Smith insisted that he had documentation for all the information contained in the Financial Statement, he could not definitely state who provided him with each individual piece of documentation. Smith agreed that although it was standard practice for him to talk to people about any financial statements he was preparing for them, he did not review the Financial Statement with or provide the Financial Statement to O'Donnell, nor did he see O'Donnell sign the Financial Statement.

After the close of evidence, the bankruptcy court concluded that Toye had met his burden of proof on most elements of his claim under § 523(a)(2)(B), but took under advisement the issue of whether O'Donnell had "caused [the Financial Statement] to be made or published with intent to deceive." See 11 U.S.C. § 523(a)(2)(B)(iv).

On March 20, 2012, the bankruptcy court entered its Final Judgment in favor of Toye, excepting O'Donnell's obligation to Toye from discharge under § 523(a)(2)(B). In its oral

findings and conclusions, the bankruptcy court found that although O'Donnell tried to portray Smith as Toye's agent, Smith was actually O'Donnell's agent in the Alder Street transaction. The bankruptcy court stated:

> Mr. Smith said he could help find the bridge financing that Mr. O'Donnell wanted. Mr. O'Donnell gave him some figures relating to accounts and the like. Mr. Smith, through his familiarity and past work with Mr. O'Donnell whereby he had helped find financing, put together a financial statement on Mr. O'Donnell's behalf and submitted it to Mr. Toye.

Although the bankruptcy court acknowledged that O'Donnell did not actually review or sign the Financial Statement, it stated that nondischargeability under § 523(a)(2)(B) can be based on whether the debtor "turned a blind eye to it in reckless disregard of the truth or falsity of the propositions asserted in the [F]inancial [S]tatement." In this regard, the bankruptcy court stated:

> In this case, Mr. O'Donnell said to Smith, go ahead and give him what . . . Mr. Toye needs to extend the credit. Those papers prepared by Mr. Smith with the authority of Mr. O'Donnell and submitted in order to get 400-and-some-thousand dollars worth of financing approved by virtue of Mr. O'Donnell's personal guarant[y], were done on the authority and at the instruction of Mr. O'Donnell and no one else. For Mr. O'Donnell is too clever and too nice for Mr. O'Donnell to disclaim that he has responsibility for the financial statement was materially false that he set in motion and that he turned a – willfully turned a blind eye to the content of that. . . . [H]e did it intending whatever it was to be sufficient in Mr. Toye's eye . . . and he did that happily not caring what the exact content was. That's damning under Section 523(a)(2)(B), it's willful disregard of the truth of what was represented and submitted in order to obtain the financing that he desired and ultimately received.

As to the alternative theory under which Toye asserted that Ferrante's fraud could be imputed to O'Donnell, the bankruptcy court found that the evidence did not establish that existence of a partnership or joint venture sufficient to impute Ferrante's fraud on O'Donnell.

This appeal followed.

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JURISDICTION

Before addressing the merits of an appeal, we must determine that we have jurisdiction, even if the issue is not raised by the litigants. See Boylan v. George E. Bumpus, Jr. Constr. Co. (In re George E. Bumpus, Jr. Constr. Co.), 226 B.R. 724 (B.A.P. 1st Cir. 1998). We have jurisdiction to hear appeals from: (1) final judgments, orders, and decrees; or (2) with leave of court, from certain interlocutory orders. 28 U.S.C. § 158(a); Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998). A decision is considered final if it "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment," id. at 646 (citations and internal quotations omitted), whereas an interlocutory order "'only decides some intervening matter pertaining to the cause, and . . . requires further steps to be taken in order to enable the court to adjudicate the cause on the merits.'" Id. (quoting In re American Colonial Broad. Corp., 758 F.2d 794, 801 (1st Cir. 1985)). Generally, a bankruptcy court's determination regarding the dischargeability of a debtor's obligations under § 523(a)(2) is a final appealable order. See Blacksmith Invs., Inc. v. Woodford (In re Woodford), 418 B.R. 644, 649 (B.A.P. 1st Cir. 2009); Aoki v. Atto Corp. (In re Aoki), 323 B.R. 803, 811 (B.A.P. 1st Cir. 2005); Cambio v. Mattera (In re Cambio), 353 B.R. 30, 31 n.1 (B.A.P. 1st Cir. 2004). Werthen v. Werthen (In re Werthen), 282 B.R. 553, 555-56 (B.A.P. 1st Cir. 2002), aff'd, 329 F.3d 269 (1st Cir. 2003). Accordingly, we have jurisdiction to hear this appeal.

STANDARD OF REVIEW

Appellate courts apply the clearly erroneous standard to findings of fact and *de novo* review to conclusions of law. See Lessard v. Wilton-Lyndeborough Coop. School Dist., 592

F.3d 267, 269 (1st Cir. 2010). A bankruptcy court's determination of whether a requisite element of a nondischargeability claim under § 523(a)(2)(B) is present is a factual determination which is reviewed for clear error. Douglas v. Kosinski (In re Kosinski), 424 B.R. 599, 607 (B.A.P. 1st Cir. 2010) (citing Lentz v. Spadoni (In re Spadoni), 316 F.3d 56, 58 (1st Cir. 2003); Palmacci v. Umpierrez, 121 F.3d 781, 785 (1st Cir. 1997); Century 21 Balfour Real Estate v. Menna (In re Menna), 16 F.3d 7, 11 (1st Cir. 1994)); see also Morrison v. Western Builders of Amarillo, Inc. (In re Morrison), 555 F.3d 473, 482 (5th Cir. 2009) ("The bankruptcy court's determination of intent to deceive is a finding of fact subject to the clearly erroneous standard of review."); Northland Nat'l Bank v. Lindsey (In re Lindsey), 443 B.R 808, 812-13 (B.A.P. 8th Cir. 2011) ("Whether a requisite element of a claim of nondischargeability under § 523(a)(2)(B) has been satisfied is a factual determination that is reviewed for clear error.").

A finding is clearly erroneous when, although there is evidence to support it, the reviewing court "is left with the definite and firm conviction that a mistake has been committed. Hannigan v. White (In re Hannigan), 409 F.3d 480, 482 (1st Cir. 2005) (quoting Anderson v. Bessemer City, N.C., 470 U.S. 564, 573 (1985)); Chase v. Harris (In re Harris), 385 B.R. 802, 804 (B.A.P. 1st Cir. 2008). If the trial court's account of the evidence is plausible in light of the record viewed in its entirety, a reviewing court may not reverse, even if convinced that if it had been sitting as a trier of fact, it would have weighed the evidence differently. In re Harris, 385 B.R. at 804 (citations omitted). When reviewing the evidentiary record, great deference is accorded to the bankruptcy court's factual determinations when they are based on the credibility and the demeanor of the witnesses. See Palmacci v. Umpierrez, 121 F.3d at 785; Rodriguez-Morales v. Veterans Admin., 931 F.2d 980, 982 (1st Cir. 1991).

DISCUSSION

I. Section 523(a)(2)(B) Exception to Discharge

Section 523(a)(2)(B) makes nondischargeable 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). A creditor seeking to except a debt from discharge bears the burden of proving each of these elements by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (1991).

O'Donnell concedes the existence of the first three elements. He challenges, however, the bankruptcy court's findings with respect to the fourth prong of § 523(a)(2)(B). Thus, the only issue before us is whether, upon the record before it, the bankruptcy court clearly erred when it found that Toye had met his burden of proving that: (1) O'Donnell caused the Financial Statement to be made or published; and (2) that he did so with the intent to deceive Toye.

II. Whether the bankruptcy court clearly erred in finding that O'Donnell caused the Financial Statement to be made or published.

The bankruptcy court found that O'Donnell, through his agent Smith, caused the false Financial Statement to be made. O'Donnell argues that § 523(a)(2)(B)(iv) was not satisfied because he did not prepare or sign the Financial Statement, nor had he ever reviewed, adopted, or otherwise authenticated or ratified it. He also argues that bankruptcy court erred in finding that Smith was his agent in connection with the Loan.

It is well established that a debtor need not personally prepare or sign the written statement to satisfy the requirements of § 523(a)(2)(B). See Am. Gen. Fin. Servs., Inc. v. Johnson (In re Johnson), 436 B.R. 116, 119 (Bankr. E.D. Mo. 2010) ("To satisfy the materially false writing requirement of [§] 523(a)(2)(B), the written statements need not be physically prepared by a debtor."). Thus, a debtor cannot escape liability under § 523(a)(2)(B) just because a financial statement was completed by someone else. See Insouth Bank v. Michael (In re Michael), 265 B.R. 593, 598 (Bankr. W.D. Tenn. 2001). Rather, the requirements of § 523(a)(2)(B) are met as long as the financial statement was either written by the debtor, signed by the debtor, written by someone else but adopted or used by the debtor, or if the debtor caused the statement to be prepared. See Mitsubishi Motor Sales of Caribbean, Inc. v. Seda Ortiz, 418 B.R. 11, 22 (D.P.R. 2009) (stating that to prove elements of § 523(a)(2)(B), the statement "must have been either written by the debtor, signed by the debtor, or written by someone else but adopted and used by the debtor."); Tower Credit, Inc. v. Williams (In re Williams), 431 B.R. 150, 157 n.16 (Bankr. M.D. La. 2010) ("As long as the written statement is written, signed, adopted or used by the debtor, the basic precondition concerning the writing requirement to the non-dischargeability complaint under [§] 523(a)(2)(B) is met"); Regions Bank v. Whisnant (In re Whisnant), 411 B.R. 559, 564-65 (Bankr. E.D. Tenn. 2009) (holding that statement does not have to be prepared by debtor to satisfy the written statement requirement; however, debtor "must have either created it, had it created, or allowed it to be 'published' by making it public or circulating it."); Chevy Chase Fed. Sav. Bank v. Graham (In re Graham), 122 B.R. 447, 451 (Bankr. M.D. Fla. 1990) ("A written statement does not have to be physically prepared by a

defendant. The requirements of § 523(a)(2)(B) are met if the existence of a written statement was caused to be prepared by the defendant.").

O'Donnell maintains that he did nothing to adopt or authenticate the Financial Statement. According to O'Donnell, in order to adopt a financial statement for purposes of § 523(a)(2)(B), a debtor must take some affirmative and intentional action to approve the content of that statement. O'Donnell claims he never took any such affirmative action; he never reviewed the Financial Statement before it was submitted to Toye, did not sign it himself, and, in fact, did not even know of its existence until after Toye obtained a judgment against him in state court. Thus, he argues, he cannot be deemed to have adopted the content of the false Financial Statement. Toye argues, however, that since O'Donnell caused the Financial Statement to be made by enlisting Smith to complete and submit the paperwork for the Loan, he is responsible for its contents. We agree.

The bankruptcy court found that Smith was O'Donnell's agent with respect to the Alder Street transaction, and that Smith prepared the paperwork "on the authority and at the instruction of O'Donnell and no one else." There is ample support in the record for the bankruptcy court's finding that Smith was acting as O'Donnell's agent in connection with the Loan. Both Smith and O'Donnell testified that Smith had assisted Ferrante and O'Donnell on several prior business transactions, including two transactions (the NCCS Transaction and the Katahdin Transaction) within six months prior to the Alder Street transaction. O'Donnell testified that he relied on Smith, who had greater expertise in commercial lending, to address all necessary paperwork for those prior transactions. He did not tell Smith which forms to fill out or give him a list of forms; instead, O'Donnell trusted Smith to generate all necessary documents. In both instances, Smith

received certain financial information from O'Donnell, obtained some information from other sources, filled out a personal financial statement for O'Donnell, and submitted it to the respective lenders.

With respect to the Loan, the record shows that although Ferrante primarily handled the Alder Street transaction, and asked Smith to arrange the financing, O'Donnell knew about this request and acquiesced in Smith's involvement. Moreover, O'Donnell admitted that he provided Smith with certain financial information relating to his accounts, which Smith then used to prepare a financial statement on O'Donnell's behalf. Based on the prior history between the parties, the bankruptcy court could infer that O'Donnell knew or should have known that asking Smith to complete paperwork for the Loan, and providing him with certain personal financial information, would necessarily mean that Smith would prepare and deliver any necessary personal financial statements, just as he had in the two prior instances. See Coughlin v. First Nat'l Bank of Boston (In re Coughlin), 27 B.R. 632, 636 (B.A.P. 1st Cir. 1983) ("Courts may assume that debtors intend the natural consequences of their acts."). Based on this evidence, the bankruptcy court did not clearly err in finding that Smith was acting as O'Donnell's agent in connection with the Loan, and that by requesting his agent to complete and submit the paperwork for the Loan, he caused the Financial Statement to be made or published for purposes of § 523(a)(2)(B). The next question is whether the bankruptcy court erred in finding that O'Donnell had the requisite intent to deceive.

III. Whether the bankruptcy court erred in finding that O'Donnell had the requisite intent to deceive Toye.

O'Donnell argues that there is no evidence that he intended to deceive Toye, and challenges the bankruptcy court's finding that he acted with reckless disregard as to the truth of the Financial Statement.

A creditor can prove intent to deceive through direct or circumstantial evidence. In re Sheridan, 57 F.3d 627, 633 (7th Cir. 1995). A debtor, however, will rarely admit that he intended to deceive a creditor. Courts have thus held that intent to deceive under § 523(a)(2)(B) may be inferred from the totality of the circumstances surrounding the debtor's acts, including the debtor's reckless indifference to, or reckless disregard of, the accuracy of the financial information submitted to the creditor. See, e.g., Insurance Co. of N. Am. v. Cohn (In re Cohn), 54 F.3d 1108, 1119 (3d Cir. 1995) ("[A] creditor can establish intent to deceive by proving reckless indifference to, or reckless disregard of, the accuracy of the information in the financial statement of the debtor when the totality of the circumstances supports such an inference."); Southeast Neb. Coop. Corp. v. Schnuelle (In re Schnuelle), 441 B.R. 616, 624 (B.A.P. 8th Cir. 2011) (citations omitted); Helena Chem. Co. v. Richmond (In re Richmond), 429 B.R. 263, 298 (Bankr. E.D. Ark. 2010); First State Bank of Munich v. Braathen (In re Braathen), 364 B.R. 688, 702 (Bankr. D.N.D. 2006); see also In re Coughlin, 27 B.R. at 636. "A bankruptcy court's determination that a debtor did not act with the intent to deceive is a finding of fact" and subject to the clearly erroneous standard of review. Hudgens v. New Equip. Leasing Inc. (In re Hudgens), 149 Fed. App'x 480, 486 (7th Cir. 2005) (citation omitted). "Ultimately . . . , where a debtor testifies as to her subjective intent, the bankruptcy court must make a credibility determination, considering the debtor's testimony, along with other objective circumstantial

evidence of the debtor's subjective intent." AT&T Universal Card Servs. v. Mercer (In re Mercer), 246 F.3d 391, 409 (5th Cir. 2001) (citing In re Sheridan, 57 F.3d at 633-34).

As one court stated:

> A determination of intent under this section is much like a determination of reasonable reliance; an objective standard to be determined by the fact finder. Intent to deceive may either be demonstrated by proof that the debtor acted intentionally or knowingly or in the alternative that debtor's conduct exhibited reckless indifference to the existing facts. Necessarily, debtor's intent cannot be divined in a vacuum but must be viewed in light of the circumstances of the case. Therefore, a debtor's credibility is an important factor in determining whether the debtor's intent to deceive was present. . . .

Tex. Am. Bank, Tyler, N.A. v. Barron (In re Barron), 126 B.R. 255, 260 (Bankr. E.D. Tex. 1991) (internal citations and quotations omitted).

The bankruptcy court found that O'Donnell, through his agent Smith, had caused the false Financial Statement to be made, and that in doing so, O'Donnell "willfully turned a blind eye to the content" of the Financial Statement and, therefore, acted with "willful disregard of the truth of what was represented and submitted in order to obtain the financing that he desired and ultimately received." O'Donnell argues that the bankruptcy court's conclusions are inconsistent with the evidence. According to O'Donnell, although he admits that he provided certain financial information to Smith, that information was completely accurate and he cannot be held responsible for false information provided to Toye in a financial statement which he did not review or approve. Thus, O'Donnell claims, there was no evidence that he intended to deceive Toye.

A bankruptcy court can, however, find evidence of intent to deceive despite a debtor's claim of ignorance. See, e.g., FDIC v. Reisman (In re Reisman), 149 B.R. 31, 38 (Bankr. S.D.N.Y. 1993).

> A debtor cannot escape liability under section 523(a)(2)(B) by firmly putting his head in the sand and later claiming not to have known of the falsity of representations that were made on his behalf while his head was covered. Such conduct is sufficiently reckless to give rise to nondischargeable liability under section 523(a)(2)(B).

Merchants Bank of Cal. v. Oh (In re Oh), 278 B.R. 844, 860 (Bankr. C.D. Cal. 2002). Thus, a debtor's ignorance can be sufficiently reckless to satisfy the intent requirement. Citizens Bank of Washington Co. v. Wright (In re Wright), 299 B.R. 648, 660-61 (Bankr. M.D. Ga. 2003).

For example, in In re Reisman, the bankruptcy court found that the debtor caused false financial statements to be submitted with the intent to deceive the bank even though the statements in issue were prepared and furnished to the bank by the debtor's accountant. In that case, the debtor claimed ignorance of the fact that his accountant prepared and delivered false financial statements in order to induce the bank to extend credit to the debtor. 149 B.R. at 33. The bankruptcy court found that the debtor caused the false financial statement to be submitted to the bank with intent to deceive because the debtor knew his personal financial statement was required as a condition of the loan, he was aware that his accountant submitted the statements to the bank, he recklessly disregarded their accuracy and, in any case, the debtor accepted the benefits of his accountant's misdeeds and thus was liable on agency principals. Id. at 38.

This case presents a similar situation. As noted above, O'Donnell was an experienced real estate developer, and in many prior instances where he provided personal guaranties, he was required to submit personal financial statements prepared either by Smith or by someone else.

With respect to the Alder Street transaction, he knew that he needed to provide a personal guaranty, and that Toye would require additional assurances as he had no prior dealings with O'Donnell. O'Donnell personally submitted certain financial information to Smith, and O'Donnell knew that Smith would use his financial information to prepare some kind of personal financial statement to give to Toye. Thus, O'Donnell had a responsibility to inquire about what kind of documentation Smith was preparing and to follow up with Smith in order to review the accuracy of the Financial Statement before it was submitted to Toye. At trial, O'Donnell testified that he did not know what kind of financial statement Smith was preparing to give to Toye, but the bankruptcy court apparently did not find that assertion to be credible or plausible. Although the bankruptcy judge did not expressly make a credibility finding, he was clearly in the best position to evaluate the testimony of the witnesses, and implicit in his finding that O'Donnell had "turned a blind eye" is a rejection of O'Donnell's claims of innocence. As noted above, where intent is at issue, we must give the bankruptcy judge's assessment of O'Donnell's credibility great deference. In re Bonnanzio, 91 F.3d at 302 (citations omitted). The bankruptcy judge considered the totality of the circumstances, including O'Donnell's actions and his testimony, and found that O'Donnell acted with reckless disregard for the truth or accuracy of the Financial Statement. Although the bankruptcy judge's findings regarding O'Donnell's intent to deceive could have been more amply supported in his bench ruling, we are not "left with the definite and firm conviction that a mistake has been committed." In re Hannigan, 409 F.3d at 482. (citation and internal quotations omitted).

Moreover, even if we were to accept O'Donnell's argument that he was unaware that the Financial Statement was submitted to Toye, he is nevertheless responsible for the acts of his

agent, Smith. "When agents act within the scope of their actual or apparent authority, the principal is liable for their acts of fraud." In re Reisman, 149 B.R. at 38 (citations omitted). Smith acted within the scope of his ostensible authority when he submitted the Financial Statement to Toye on O'Donnell's behalf, and O'Donnell accepted the benefits of Smith's submission of the false Financial Statement (i.e., the Loan from Toye). O'Donnell cannot escape the consequences of his agent's bad acts.

Thus, we conclude that the record, taken as a whole, supports the bankruptcy court's finding that O'Donnell acted with the requisite intent to deceive, and that the bankruptcy court's finding is not clearly erroneous.

CONCLUSION

We conclude that the bankruptcy court did not err in finding that Toye had met his burden of proving that O'Donnell caused the Financial Statement to be made or published with the intent to deceive Toye. Accordingly, we **AFFIRM** the bankruptcy court's determination that Toye's claim is excepted from discharge under § 523(a)(2)(B).