UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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June 11, 1999

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Subject: *RCB Bank v. David K. Olsen (In re Olsen)*,
Adversary No. 98-1026;
Chapter 7; Bankr. No. 98-10213

Dear Counsel:

The matter before the Court is Plaintiff RCB Bank's complaint seeking a determination that its claims against Defendant-Debtor David K. Olsen are non dischargeable. This is a core proceeding under 28 U.S.C. § 157(b)(2)(B). This letter decision, accompanying order, and subsequent judgment shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that the Bank's claims are dischargeable.

SUMMARY OF FACTS. RCB Bank is located in Oklahoma. David K. Olsen (Olsen) and Olsen Companies, Ltd. (corporation), a family construction corporation of which Olsen was a principal, were also located in Oklahoma.

In April 1995, the corporation borrowed funds from the Bank for operating and capital funds. The corporation's primary contact person with the Bank was Olsen's brother Lou. The corporation gave the Bank a December 1994 financial statement. In making the loan, the Bank relied on the financial statement, a credit check of some sort, and the recommendation of a Bank director who had used the corporation's services. The Bank obtained a blanket security interest in the corporation's assets. Olsen guaranteed the debt. The Bank requested but did not obtain a copy of the corporation's depreciation schedules or tax returns. The Bank also requested but did not receive the titles to the corporate vehicles pledged as security.

16.

In June 1995, Olsen personally borrowed $12,720.00 from the Bank to purchase two jet skis and a trailer. He gave the Bank a security interest in the jet skis and trailer. As part of the security agreement, Olsen agreed to keep the Bank informed about his address and the location of the collateral. The Bank filed a UCC-1 statement in Oklahoma to perfect its interest.

In November 1995, the Bank made a new note with the corporation to pay the first note. No new funds were advanced. The Bank still had not received from the corporation all the depreciation schedules, tax returns, and vehicle and trailer titles it had requested earlier with the first note. The Bank also asked for an updated financial statement, including a current list of assets, but did not receive it.

The corporation had severe financial problems in 1996. Sometime in 1996, it gave title to two trucks[1] to Olsen's father in repayment of loans from him. According to Olsen, the trucks had been originally titled under their father's name but had been put under the corporate name for insurance purposes.

In 1997, Olsen moved to South Dakota with some corporate property and the two jet skis and trailer. The Bank, learning of the move, sent a representative to South Dakota and eventually repossessed some collateral. The Bank did not take the jet skis and trailer that secured Olsen's personal note because Olsen wanted to sell the collateral himself to realize his equity in them. The Bank filed a notice in South Dakota of its security interest in the jet skis and trailer on September 15, 1997. Olsen did not sell the jet skis but did title them in South Dakota. The Bank's lien was not noted on the titles.

In March 1998, the Bank obtained a judgment in Oklahoma against Olsen for $39,915.97 plus interest on the corporate note guarantee. The judgment was transcribed to the Circuit Court for Spink County, South Dakota in June 1998. Also in March 1998, the Bank obtained a judgment in Oklahoma against Olsen for $8,804.26 plus statutory interest on the jet skis and trailer loan. That judgment was also transcribed to the Circuit Court for Spink County, South Dakota in June 1998. In July, the jet skis and trailer were repossessed by the local sheriff on an execution of the judgment.

On August 7, 1998, Olsen filed a Chapter 7 petition in bankruptcy. On November 16, 1998, the Bank commenced this

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[1] The testimony was unclear about whether trailers, tractors or both were transferred by the corporation to Olsen's father in 1996. Exhibit 11 indicates trailers. Olsen's testimony included more general references to trucks.

adversary proceeding seeking a declaration that the unsecured judgment debts are non dischargeable under 11 U.S.C. §§ 523(a)(2) or (a)(4).

In February 1999, the case trustee, recognizing that the Bank's judgment was transcribed in South Dakota within the voidable preference period and that the Bank's liens had not been timely noted on the South Dakota titles to the jet skis and trailer, negotiated a settlement of the Bank's relief from stay motion and a related adversary proceeding which the trustee had commenced. Under the settlement, the Trustee got possession of the jet skis and trailer and agreed to split the net sale proceeds with the Bank.

A trial was held May 25, 1999 on the Bank's non dischargeability complaint and the matter was taken under advisement.

Discussion. The party opposing discharge of a particular debt has the burden of proving the debt is non dischargeable by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 286-88 (1991). The fraud-based exceptions to discharge are construed narrowly in the debtor's favor. *Werner v. Hoffman*, 5 F.3d 1170, 1172 (8th Cir. 1993).

11 U.S.C. § 523(a)(2)(A). In its complaint, the Bank did not specify whether it was seeking relief under § 523(a)(2)(A) or (B). Based on the pleadings and circumstances presented, it appears that subsection (A) applies to the Bank's allegations of general fraud or wrongful acts and omissions and that subsection (B) applies to the Bank's allegations regarding Olsen's use of the corporation's financial statement.

The Bank raised several allegations of fraud under § 523(a)(2)(A): that the corporation borrowed funds without an intent to repay; that Olsen hid or secreted corporate assets by not submitting the additional information requested by the Bank; that Olsen took corporate property and the jet skis and trailer to South Dakota to keep them from the Bank; and that Olsen wrongfully turned over the Bank's collateral to his father. The Bank has not shown that its claims against the corporation and Olsen, as a guarantor, arose from these acts or omissions, most if not all of which occurred after the loans were made. *Cohen v. De La Cruz*, 118 S.Ct. 1212, 1217 (1998). Further, the evidence -- circumstantial or direct -- does not establish that Olson committed actual fraud, that he made any expressly fraudulent statements, or that by conduct he intentionally mislead the Bank. *Caspers v. Van Horne (In re Van Horne)*, 823 F.2d 1285, 1287 (8th Cir. 1987)(proving intent); *Still v. Patten (In re Patten)*, 225 B.R. 211, 215(Bankr. D. Or.

1998)(discussion of distinctions between actual fraud, false pretenses, and false representation as found in § 523(a)(2)(A)). Nothing more has been shown by the Bank other than that Olsen moved to South Dakota, that he took some of the Bank's collateral with him without formally notifying the Bank, that he turned over some collateral to his father in repayment of loans from him,[2] and that the Bank did not timely seek recourse after Olsen and the corporation defaulted on their notes. Business deals gone sour are not grounds for declaring a debt non dischargeable. *Coenco, Inc., v. Coenco Sales, Inc.*, 940 F.2d 1176, 1178 (8th Cir. 1991)("A fraud case cannot be won by a showing of broken promises and unrealized business potential.")

The Bank also complained that Olsen's schedules and statement of financial affairs were incomplete or inaccurate. There is no relief under § 523(a) for those transgressions. A complaint under § 727(a) more appropriately addresses them.

11 U.S.C. § 523(a)(2)(B). For a debt to be declared non dischargeable under § 523(a)(2)(B), the creditor must show, in addition to an intent to deceive, that the debtor obtained credit by use of a materially false written statement regarding his financial condition and that the creditor reasonably relied on the financial statement. The reasonableness of a creditor's reliance on the false financial statement must be judged in light of the "totality of the circumstances." *Sinclair Oil Corp. v. Jones (In re Jones)*, 31 F.3d. 659, 662 (8th Cir. 1994) (quoting *Coston v. Bank of Malvern (In re Coston)*, 991 F.2d 257, 261 (5th Cir. 1993)); *First National Bank of Olathe, Kansas v. Pontow*, 111 F.3d 604, 610 (8th Cir. 1997). The Court may consider whether there were any "red flags" that would have alerted a prudent lender that the statement was not accurate. *Id.* The Court also may consider whether even a minimal investigation should have revealed the inaccuracy of the debtor's representations or whether the statement was stale. *Id.*

The Bank has not shown that its reliance on the corporation's December 1994 financial statement was reasonable when it made its November loan to the corporation. Already aware that the financial

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[2] A separate legal proceeding involving Olsen's father would be necessary to determine whether Olsen's father had a superior lien on the corporation's two trucks that were turned over to him. That issue was not plead in this adversary proceeding and Olsen's father is not a party to this action. Only claims of non dischargeability were raised here.

statement needed to be updated and already knowing that the corporation had not provided the tax returns or depreciation schedules that had been requested by the Bank when it made the first loan, the Bank still made the new loan in November 1995. Accordingly, the Court cannot find that the Bank relied on the corporations' 1994 financial statement *at all* in making the November 1995 loan, let alone reasonably relied on it. As stated by the Bank's officer, Raymond E. Pruitt, the loan to the corporation was initially made on a Bank's director's recommendation and on the December 1994 financial statement and its known limitations. It does not appear that the Bank's reliance enlarged at all when the November 1995 loan was made.

11 U.S.C. § 523(a)(4). For a debt to be declared non dischargeable under § 523(a)(4), the debtor must have acted fraudulently or in defalcation of duty while in a fiduciary capacity. The fiduciary capacity must arise from an express, not constructive, trust. *Barclays American/ Business Credit, Inc., v. Long (In re Long)*, 774 F.2d 875, 878-79 (8th Cir. 1985). Whether a party is a fiduciary under § 523(a)(4) is a question of federal law. *Kunzler v. Bundy (In re Bundy)*, 95 B.R. 1004, 1013 (Bankr. W.D. Mo. 1989). However, state law is relevant when deciding whether an express trust relationship exists. *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986); *Bundy*, 95 B.R. at 1013. The fiduciary relationship to which § 523(a)(4) applies does not cover trusts imposed on transactions by operation of law or as a matter of equity. *ITT Life Insurance Co. v. Haakenson (In re Haakenson)*, 159 B.R. 875, 887 (Bankr. D.N.D. 1993).

> "[F]iduciary as used in 11 U.S.C. § 523(a)(4) is limited to the class of fiduciaries including trustees of specific written declarations of trust, guardians, administrators, executors, or public officers and, absent special considerations, does not extend to the more general class of fiduciaries such as agents, bailees, brokers, factors, and partners."

Huhman v. Braudis (In re Braudis), 86 B.R. 1001, 1004 (Bankr. W.D.Mo. 1988)(quoting *In re Holman*, 42 B.R. 848, 850-51 (Bankr. E.D. Mo. 1984)).

The evidence presented in this adversary proceeding does not support a conclusion that Olsen was the Bank's fiduciary. There has been no showing by the Bank that any agreement between Olsen and the Bank created an express trust relationship between them. They remained a lender and borrower.

An order directing entry of a judgment for Defendant-Debtor Olsen shall be entered. Counsel for Defendant-Debtor shall prepare an appropriate judgment.

Sincerely,

Irvin N. Hoyt
Bankruptcy Judge

INH:sh

CC: adversary file (docket original; serve copies on parties in interest)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

JUN 11 1999

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to the parties on the attached service list.

JUN 11 1999

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota
By M. Kay Rosen

Case: 98-01026 Form id: 122 Ntc Date: 06/11/1999 Off: 3 Page : 1
Total notices mailed: 4

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