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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October 20, 1994

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Subject: ***LeRoy Oleson v. Richard R. Olson (In re Olson),***
Adversary No. 93-5018;
Chapter 7; Bankr. No. 93-50232

Dear Counsel:

The matter before the Court is the dischargeability complaint filed by Plaintiff LeRoy Oleson. This is a core proceeding under 28 U.S.C. § 157(b)(2). This letter memorandum of decision and accompanying Order shall constitute findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that Defendant-Debtor Richard R. Olson's debt to Plaintiff LeRoy Oleson is dischargeable.

On February 24, 1988, Richard R. Olson, individually and as president of Universal Sales Enterprises, Inc. (Universal Sales), and LeRoy Oleson filed a stipulated judgment in state court that gave LeRoy Oleson a judgment against Richard R. Olson and Universal Sales for $191,200.00 plus interest. The judgment was the product of prior financial deals between LeRoy Oleson and Richard R. Olson. The stipulation provided that Richard R. Olson had borrowed[1] large sums from LeRoy Oleson between 1982 and 1985 and that Richard R. Olson had assured LeRoy Oleson of repayment plus interest as well as a substantial return on his shareholder interest. The judgment was to be paid by Universal Sales in its Chapter 11 case or by Richard R. Olson. LeRoy Oleson was to release his 20% stock ownership in Universal Sales upon payment of the judgment. The

[1] The Stipulated Judgment described the transactions between Oleson and Olson as loans. That description is recognized herein.

stipulation gave Richard R. Olson and Universal Sales one year to pay the debt without threat of execution or other means of enforcement. The judgment was never satisfied.

On September 17, 1993, Richard R. Olson (Debtor) filed a Chapter 7 petition. LeRoy Oleson commenced this adversary proceeding on December 28, 1993 asking the Court to declare the judgment debt non dischargeable under 11 U.S.C. § 523(c)[2] based on Debtor's fraudulent actions. An evidentiary hearing was held June 7, 1994. Appearances included Brad P. Gordon for Plaintiff LeRoy Oleson and James P. Hurley for Defendant-Debtor Richard R. Olson. The amount of the debt already having been established by the stipulated judgment, the purpose of the evidentiary hearing was to provide evidence on whether Debtor fraudulently procured the investment funds from Plaintiff.

Debtor persuaded Plaintiff to invest in Universal Sales on representations that Universal Sales would successfully market an automobile gas saving device and that Plaintiff would be repaid his loans and also get a sizeable return on the corporate stock he had been given. Universal Sales operated loosely. Meetings of the board of directors or shareholders, which both included Plaintiff, were never held. Debtor always had one excuse or another for Plaintiff and other investors regarding repayment of loans and the status of their investments. Debtor kept coming back to Plaintiff for more money with further promises that the product was about ready to be marketed.

Universal Sales' efforts switched from manufacturing and marketing the gas saving device to manufacturing and marketing an oil filled space heater. Plaintiff did not object to this change. While the heater venture was not successful, Universal Sales did have employees, described by Plaintiff as "good" employees, who worked on improving and building the heaters. Universal Sales also employed a bookkeeper. Plaintiff had some access to the business records and he had near constant access to the plant while he was involved with Debtor. Plaintiff and his wife even lived in and operated a business from the same building for a time rent-free. Plaintiff and his wife also traveled with Debtor on a few business trips. Most important, Universal Sales manufactured some heaters, although faulty, and Debtor and his associates put forth an identifiable marketing effort. A few units were sold, often by word of mouth. Ultimately, Plaintiff and other investors and associates of Debtor's broke away from Debtor. Some, including Plaintiff, then attempted to manufacture and market the heaters

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[2] In his post-trial pleadings, Plaintiff relied on 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(4).

under a different corporate entity. Universal Sales filed for bankruptcy in 1985.

Debtors constant delays and continued puffing about his business ventures culminated in the large debt to Plaintiff. That Debtor is a poor businessperson is a vast understatement. His true classification is somewhere between a con man and a dreamer. Debtor is someone with a lot of big ideas but who never quite brings those ideas to fruition. Those facts applied to §§ 523(a)(2) or (4), however, do not lead to a conclusion that the debt to Plaintiff is non dischargeable.

The party opposing discharge has the burden of proving the debt is non dischargeable by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279 (1991). The statutory exceptions to discharge are narrowly construed. *Werner v. Hofmann,* 5 F.3d 1170, 1172 (8th Cir. 1993).

False Representations, Other than a Statement Regarding Financial Condition. A debt for money, property, services, or an extension or renewal of credit is excepted from discharge under § 523(a)(2)(A) to the extent is was obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." As § 523(a)(2)(A) is interpreted by case law, the party opposing discharge must show that:

1. the debtor made the false representation;
2. at the time made, the debtor knew them to be false;
3. the representations were made with the intention and purpose of deceiving the creditor;
4. the creditor actually relied on the representation; and
5. the creditor sustained the alleged injury as a proximate result of the representations having been made.

Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987); *Thul v. Ophaug (In re Ophaug)*, 827 F.2d 340 (8th Cir. 1987). Evidence of the surrounding circumstances may be presented from which intent may be inferred. *Van Horne*, 823 F.2d at 1287. (cites therein). The debtor may be required to overcome the circumstantial evidence with more than unsupported assertions of honest intent. *Id*. at 1287-88 (cites therein).

Circumstantial evidence supports Plaintiff's premise that Debtor borrowed the money with no intent to repay Debtor. This circumstantial evidence includes Debtor's evasion of creditors' questions and concerns, his many corporate creations without attention to corporate formalities, his lack of candor about other

parties' interests in his ventures, and his lack of success. Debtor overcame this circumstantial evidence, however, by showing the extent to which Debtor and his associates had progressed on manufacturing and marketing both the fuel saving device and the heater. Debtor also presented some evidence of the funds Universal Sales received, including those from Plaintiff and Debtor himself, and how those funds were spent.

> A fraud case cannot be won by a showing of broken promises and unrealized business potential. [The plaintiff must] show not only that the defendants did not keep their promises, but also that they did not intend to keep them when they made them (or that they knew they could not keep them).

Coenco, Inc., v. Coenco Sales, Inc., 940 F.2d 1176, 1178 (8th Cir. 1991). Here, there was no evidence that Debtor did not intend to keep his promises to Plaintiff or that he knew he could not keep them when he made them. As Roy Richards, a fellow investor of $50,000.00 in the heater venture testified, "It was a business investment [that] didn't work" because of the lack of a "viable product." Further, Plaintiff continued his business relationship with Plaintiff over several years; that relationship simply lasted too long for the Court to conclude that Plaintiff was mislead throughout that time by Debtor. Consequently, the debt will not be declared non dischargeable under § 523(a)(2)(A).

Fraud by a Fiduciary. For a debt to be declared non dischargeable under § 523(a)(4), the debtor must have acted fraudulently 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). Here, the debt to Plaintiff was created by the loans Plaintiff made to Debtor. Thus, the debt arose out of a contractual relationship, not a fiduciary relationship. While Debtor, as a corporate officer, may have stood in a fiduciary capacity to Plaintiff, as a shareholder, the debt did not arise out of that relationship.

> It is the substance of a transaction, rather than the labels assigned by the parties, which determines whether there is a fiduciary relationship for bankruptcy purposes.

Long, 774 F.2d at 878 (citing *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934)). Accordingly, the debt may not be declared non dischargeable under § 523(a)(4). *Werner*, 5 F.3d at 1172.

Debtor's propensity toward creating corporate entities without

insuring that attendant formalities are followed thereafter is troubling. The protection that formalities such as regular board and shareholder meetings offer may have better safeguarded investors and lenders from Debtor's failings as a business manager. However, Plaintiff and other lenders and investors did not utilize legal remedies available to them to insure that corporate formalities were observed by Universal Sales. The Chapter 7 process, coming after the business has failed, does not offer commensurate remedial solutions for investors and lenders.

An appropriate judgment will be entered.

The state court file will be returned to that clerk of court. This Court took judicial notice of only the February 24, 1988 Stipulated Judgment since it was the product of that lawsuit.

Sincerely,

Irvin N. Hoyt
Chief Bankruptcy Judge

INH:sh

CC: Bankruptcy Clerk
United States Trustee
Trustee Dennis C. Whetzal

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In Re:	)	
	)	Bankr. Case No. 93-50232
RICHARD R. OLSON	)	Adversary Case No. 93-5018
Debtor.	)	Chapter 7
LEROY OLESON	)	
Plaintiff,	)	JUDGMENT DECLARING DEBT DISCHARGEABLE
vs.	)	
RICHARD R. OLSON	)	
Defendant.	)	

In compliance with and recognition of the letter memorandum of decision entered this day,

IT IS HEREBY ORDERED AND ADJUDGED that the stipulated judgment for $191,200.00 plus interest entered against Defendant Richard R. Olson and on behalf on Plaintiff LeRoy Oleson in the Circuit Court of the Seventh Judicial Circuit for the State of South Dakota on February 24, 1988 in Civ. No. 86-380 is *not* non dischargeable under 11 U.S.C. §§ 523(a)(2)(A) or 523(a)(4).

So ordered and adjudged this _____ day of October, 1994.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:
PATRICIA MERRITT, CLERK

By _____
Deputy Clerk
(SEAL)