

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION



IN RE:)	
)	
Brian Douglas Fisher and)	Case No. 00-10738C-7G
Melinda Bailey Fisher,)	
)	
Debtors.)	
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)	
Frank A. Francin,)	
)	
Plaintiff,)	
)	
v.)	Adversary No. 03-2024
)	
Brian Douglas Fisher and)	
Melinda Bailey Fisher,)	
)	
Defendants.)	
)	

MEMORANDUM OPINION

This adversary proceeding came before the court on June 1, 2004, for trial. David H. Idol II appeared on behalf of the Plaintiff Frank A. Francin and J. Brooks Reitzel Jr. appeared on behalf of the Debtors Brian Douglas Fisher and Melinda Bailey Fisher.

NATURE OF PROCEEDING

This is a dischargeability proceeding in which Plaintiff alleges that indebtedness of the Debtors is nondischargeable pursuant to § 523(a)(2)(B) of the Bankruptcy Code. This claim arises out of a residential lease agreement wherein Plaintiff was the lessor and Debtors were the lessees.

FACTS

Plaintiff is the owner of residential real property located at 3503 Blairwood Street, High Point, North Carolina (the "Property") which he uses as a rental property. In early September of 1999, Plaintiff met with the Debtors to discuss a possible three-year lease of the Property. At that time Plaintiff informed the Debtors that the Property, which is a five bedroom house, needed to be completely furnished by any tenants, as Plaintiff had an ongoing rental commitment to rent the Property to a furniture company, fully furnished, during the annual Fall and Spring furniture markets in High Point. Plaintiff explained to Debtors that during the furniture markets they would have to allow the Property to be occupied by employees of the furniture company, using Debtors' furniture.

On September 16, 1999, Debtors submitted a rental application for the Property to Plaintiff which was prepared on a form supplied by Plaintiff. The application stated that the male Debtor had been working at his current employer, Flooring Specialties, Inc., since June of 1996 and that his current salary as President of the company was \$86,500.00. Both Debtors signed the rental application. In addition to the rental application, Plaintiff had the Debtors submit letterhead from the male Debtor's employer confirming his position as President, contacted two references provided by the Debtors, and had a third party organization, Triad

Employment Solutions, run credit checks on both Debtors which included a call to the Debtors to verify the male Debtor's employment and salary information.

The parties entered into a lease agreement on September 26, 1999 for a three-year lease of the Property, with the lease term to begin on November 1, 1999. The monthly rental payment was reduced to \$1,575.00 per month, based upon the Debtors agreeing to assume responsibility for maintenance and repair of the interior and exterior of the Property, including appliances, during the lease term. The lease agreement listed Plaintiff's mailing address for correspondence and rent payments as P.O. Box 6073, High Point, North Carolina 27262.

The Debtors filed for bankruptcy protection under Chapter 7 of the United States Bankruptcy Code six months later, on March 28, 2000. Schedule I of the Debtors' petition stated that the male Debtor's monthly income was only \$4,000.00 and that he had worked for Flooring Specialties, Inc. since September of 1999. Plaintiff was not listed as a creditor on the matrix, and although the Debtors listed the executory residential lease agreement and Plaintiff's name in their Schedule G, they did not provide a mailing address for Plaintiff. As a result, Plaintiff was not sent any notices of the Debtors' bankruptcy. The Chapter 7 Trustee filed a report of no distribution and the Debtors were granted a discharge on July 5, 2000.

In February 2001, Plaintiff contacted the Debtors as he had not received payment for the February rent and was informed that the Debtors would be vacating the Property at the end of February. Plaintiff wrote a letter to the Debtors, attempting to convince them to stay at least through the April furniture market as he had already told his furniture company client that the Property would again be available during the Spring furniture market, but the Debtors restated their intent to vacate the Property, and did so at the end of February. Plaintiff was eventually able to secure another tenant for the Property on May 1, 2001 at a lower rental rate of \$1,450.00, but lost the furniture market tenant because the Property was unfurnished after the Debtors vacated it. Plaintiff filed a lawsuit against the Debtors in state court on February 22, 2001 to recover past due rent, late charges and fees. Debtors, through their attorney, filed a motion to dismiss the state court complaint on April 23, 2001 which did not mention the Debtors' prior bankruptcy case. After the motion to dismiss was denied, Debtors filed an Answer to the complaint on December 10, 2001 and again did not mention the Debtors' bankruptcy case. Plaintiff's attorney learned of the bankruptcy filing during the early part of 2002 and filed a motion to reopen the bankruptcy case. The Debtors' bankruptcy case was reopened on April 22, 2003 to allow Plaintiff to file this adversary proceeding.

DISCUSSION

I. Dischargeability time bar.

Under § 523(a)(3)(B), a bankruptcy discharge does not discharge an individual debtor from a debt of the kind specified in § 523(a)(2) which is not listed or scheduled in the debtor's case in time for the creditor to request determination of dischargeability under § 523(a)(2), unless the creditor had constructive or actual notice of the case in time to request it. It is clear from the record in this case that the Plaintiff was never sent any official bankruptcy notices of the Debtors' bankruptcy case as the Debtors did not list Plaintiff's mailing address, even though Plaintiff's mailing address was clearly designated within the lease. Both Debtors testified that they informed Plaintiff of their bankruptcy, but the court did not find this testimony to be credible. This court is satisfied and finds that Plaintiff had no knowledge of the Debtors' bankruptcy case until January or February of 2002, when Plaintiff was informed by his attorney that the Debtors had filed for bankruptcy protection under Chapter 7 during their occupancy of the Property and had received a discharge. The court further finds that Plaintiff had no actual or constructive notice of the Debtors' bankruptcy case and concludes that the bar date does not prevent the debt from being held to be nondischargeable under § 523(a)(2)(B).

II. Claim under § 523(a)(2)(B).

Under § 523(a)(2)(B) of the Bankruptcy Code, a Chapter 7 discharge does not discharge an individual debtor from a debt: (1) for money, property, services, or an extension, renewal, or refinance of credit; (2) to the extent it is obtained by a written statement regarding the debtor's financial condition; (3) that is materially false; (4) that the debtor caused to be made or published with an intent to deceive the creditor; and (5) the creditor reasonably relied on the written statement. A creditor seeking a determination that a debt is nondischargeable under § 523 bears the burden of proof and must show each element by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 288, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991).

1. Applicability of § 523(a)(2)(B) to real property leases.

The property interest acquired by a lessee under a real property lease constitutes "property" for the purpose of § 523(a)(2). See In re Brevard, 200 B.R. 836, 843 (E.D. Va. 1996); In re Brewer, 66 B.R. 214, 217 (S.D.N.Y. 1986); In re O'Connor, 145 B.R. 883, 891 (Bankr. W.D. Mich. 1992). Therefore, damages for breach of a lease agreement which was obtained through the fraud or false pretenses of the lessee constitute a debt which may be nondischargeable under § 523(a)(2)(B). See Brevard, 200 B.R. 836, 841-43.

2. Written statements regarding Debtors' finances.

Written statements and documents regarding a debtor's income and the source of that income which are submitted to a potential lessor are written representations regarding a debtor's financial condition. See Brewer, 66 B.R. at 217. Plaintiff has shown that the Debtors provided a signed written statement in their lease application regarding their household income, the source of that income, and the length of the male Debtor's employment. Such a statement constitutes a written statement regarding the debtor's financial condition for purposes of § 523(a)(2)(b).

3. Material falsity of the written statements.

After considering the evidence presented at the hearing, there is no question that the information provided by the Debtors on the lease application was false, as both the male Debtor's salary and his length of service with his current employer were overstated. The Debtors stated in their lease application that their annual household income was \$86,500.00. Yet in their Schedule I, filed only a few months after the Debtors entered into the lease agreement with Plaintiff, the Debtors stated under oath that their household income was only \$4,000.00 monthly, or \$48,000.00 annually. The Debtors also stated under oath in Schedule I that the male Debtor began working for Flooring Specialties, Inc. in September 1999, but the lease application submitted by the Debtors states that the male Debtor had been with his employer since June

1996.

While the statements were false, they are only materially false if they "paint[] a substantially untruthful picture of a financial condition by misrepresenting information of the type which would normally affect the decision to grant credit." In re Davis, 262 B.R. 673, 680 (Bankr. E.D. Va. 2001), citing In re Ross, 180 B.R. 121, 127 (Bankr. E.D. Va. 1994). See also In re Candland, 90 F.3d 1466, 1470 (9th Cir. 1996); In re Furio, 77 F.3d 622, 625 (2d Cir. 1996). Plaintiff's purpose for obtaining the Debtors' financial information was to determine if the Debtors could afford to make the rent payments, which is a "matter of justifiable concern to any prudent landlord." Brevard, 200 B.R. at 843-44. According to Plaintiff's testimony, his qualifying criteria in deciding whether to lease one of his properties to an individual is whether the potential lessee's total housing costs under the lease, including rent, utilities, and any required maintenance, would exceed one-third of the potential lessee's household income. Using the income information provided by the Debtors in the lease application, they would appear to meet Plaintiff's criteria. However, using the Debtors' actual income information as stated in their bankruptcy schedules, the Debtors would not have met Plaintiff's criteria for tenants. Plaintiff testified that had he known that the male Debtor only earned a gross monthly income of \$4,000.00, he would not have rented the property to the Debtors.

Since the false information on the lease application affected Plaintiff's decision to rent the Debtors the property, the information was materially false.

4. Intent to deceive.

As it is nearly impossible to obtain direct proof of a debtor's state of mind, a creditor may present evidence of the surrounding circumstances from which intent to deceive may be inferred. In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987). See also Brewer, 66 B.R. at 218 (it can be inferred that a debtor intends to deceive a creditor by submitting false information regarding the debtor's financial condition as "the debtor will be held to have intended the natural consequences of her act.") In the present case, Plaintiff requested that the Debtors fill out a lease application containing questions about the Debtors' income and employment history in order to determine whether to rent the property to them. The evidence presented at the hearing was sufficient to show by a preponderance that the Debtors knew that the information regarding the male Debtor's salary and length of employment was false at the time they filled out the lease application. Once a creditor has made a prima facie case by producing evidence that the debtor had actual knowledge of the falsity of the financial information, the "burden shifts to the debtor to rebut the presumption of intent to deceive." In re O'Connor, 149 B.R. 802, 808 (Bankr. E.D. Va. 1993). See also In re

Compton, 97 B.R. 970, 977 (Bankr. N.D. Ind. 1989). The Debtors did not overcome this inference with their unsupported assertions of honest intent. See Van Horne, 823 F.2d at 1287. In the present case, the surrounding circumstances, including the fact that the male Debtor misrepresented his income and employment history for a second time when he was contacted by Triad Employment Solutions acting on behalf of Plaintiff, were more than sufficient to establish that the Debtors intended to deceive the Plaintiff through the false statements regarding the financial condition of the Debtors. Thus, the court may infer that the Debtors submitted the false information to Plaintiff in order to deceive Plaintiff into believing that the Debtors were financially capable of assuming the responsibilities under the lease.

5. Reasonable reliance by Plaintiff.

In order to show reasonable reliance upon a false statement of a debtor's finances, "a creditor must prove that reliance was objectively reasonable and that the creditor actually relied." O'Connor, 149 B.R. at 809. See also In re Wingo, 112 B.R. 141, 145 (Bankr. W.D. Va. 1990).

A. Objectively reasonable reliance.

The fact-finder must determine what is objectively reasonable by looking at the totality of circumstances in the case. See O'Connor 149 B.R. at 809; In re Figge, 94 B.R. 654, 665 (Bankr. C.D. Cal. 1998). Such an inquiry involves measuring the creditor's

conduct in the case at hand by looking at the following: "the creditor's standard practices in evaluating creditworthiness; the standards or customs of the creditor's industry in evaluating creditworthiness; and the surrounding circumstances existing at the time of the debtor's application for credit." In re Harms, 53 B.R. 134, 141 (Bankr. D. Minn. 1985). See also O'Connor, 149 B.R. at 809; Figge, 94 B.R. at 665 (noting that reasonable reliance is established upon proof that the lender followed its regular credit procedures, that those procedures are consistent with the general practices in the industry among lenders of similar size and sophistication, and that the credit investigation did not uncover any discrepancies.)

Plaintiff is not a sophisticated financial institution or real estate management firm. He owns a total of three residential rental properties including the property in question. In this case Plaintiff followed his normal procedures when inquiring about a potential tenant's financial situation. Plaintiff asked the Debtors to fill out the standard application he always used for potential tenants, he asked for letterhead to confirm the male Debtor's position with his employer, he contacted the Debtors' references, and he used a third party inquiry from Triad Employment Solutions to further verify the responses on the lease application and to run a credit check on the Debtors. Plaintiff's steps in evaluating potential tenants were reasonable and typical of a

small-scale property manager.

"When a lessor of residential real property seeks proof of the financial condition of a prospective lessee as a condition precedent to leasing the property to the prospective lessee, such lessor is generally entitled to rely on the submitted documentation and to assume that the prospective lessee will submit truthful information." Brewer, 66 B.R. at 218. There was nothing in the lease application, Plaintiff's contacts with Debtors' references, or in the report prepared by Triad Employment Solutions which would have raised a red flag and alerted Plaintiff to the Debtors' financial inability to perform under the lease. A lessor "should not be faulted for having accepted financial figures from [individuals] who appeared to be...honest potential lessee[s]." Id. The court finds that Plaintiff's reliance on the false financial information was objectively reasonable.

B. Actual reliance.

In order to prove actual reliance, a creditor must show that the financial statements were a "substantial factor" in its decision to grant credit to the debtor. See In re Rountree, 2002 WL 832669, *4 (Bankr. M.D.N.C.); O'Connor, 149 B.R. at 810; In re Dunston, 146 B.R. 269, 279 (D. Colo. 1992); Wingo, 112 B.R. at 145. As discussed previously, Plaintiff testified at the hearing that his qualifying criteria for leasing one of his properties is that the total housing costs, including rent, maintenance and utilities,

not exceed one third of the potential lessee's gross monthly income. The total housing costs for the property in question were \$2,000.00 per month. Plaintiff further testified at the hearing that had he known that the male Debtor had only been employed for one month with his current employer rather than three years, and had he known that the Debtors' monthly gross income was only \$4,000.00, he would never have leased the property to the Debtors. Thus, Plaintiff actually and reasonably relied on the false financial information he was supplied by the Debtors.

6. Damages.

Courts are split on whether a § 523(a)(2)(B) analysis contains a causation element. See Davis, 262 B.R. at 682. Some courts have likened a claim under § 523(a)(2)(B) to a common law fraud claim and held that in order to recover, a plaintiff must show that their damages were proximately caused by the false financial information. See In re Siriani, 967 F.2d 302,306 (9th Cir. 1992); In re Johnson, 242 B.R. 283, 292 (Bankr. E.D. Pa. 1999); In re Hall, 109 B.R. 149, 153 (Bankr. W.D. Pa. 1990); Compton, 97 B.R. at 976-77 (Bankr. N.D. Ind. 1989); In re Anzman, 73 B.R. 156, 163 (Bankr. D. Colo, 1986); Brewer, 66 B.R. at 218-19; In re Long, 44 B.R. 300, 309-10 (Bankr. D. Minn. 1983). However, the weight of appellate authority would suggest that a plaintiff need not show their damages were proximately caused by the defendant's presentation of false financial information as § 523(a)(2)(B) does not include such a

requirement, and one should not be read into the section. See In re Campbell, 159 F.3d 963, 966 (6th Cir. 1998); In re MacFarland, 84 F.3d 943, 947 (7th Cir. 1996), cert denied, 519 U.S. 931, 117 S.Ct. 302, 136 L.Ed.2d 220 (1996); In re Norris, 70 F.3d 27, 29 n.6 (5th Cir. 1995); In re Goodrich, 999 F.2d 22, 25 (1st Cir. 1993); Davis, 262 B.R. at 682; In re Priestley, 201 B.R. 875, 885 (Bankr. D. Del. 1996). Regardless of whether causation is an element of a § 523(a)(2)(B) analysis, the Debtors' false financial statement was the proximate cause of Plaintiff's losses in the present case.

Those cases which have involved § 523(a)(2)(B) in the context of a lease have held that damages include the "landlord's loss of rent for the period after the tenant moved out through the termination of the lease." Brevard, 200 B.R. at 843-44 (failing to find that the debt would be excepted from discharge in that case, but agreeing with the measure of damages applied in other cases). See In re O'Connor, 145 B.R. 883, 893 (Bankr. W.D. Mich. 1992); Brewer, 66 B.R. at 216. In Brewer, the court found that the following were damages proximately caused by the debtor's presentation of false financial information in securing a residential lease: 1) rent past due at the time the debtor moved out of the premises; 2) rent for the remainder of the lease less any security deposit and mitigation by the landlord; 3) costs of locating another tenant; 4) expenses for maintenance of the property which were obligations of the debtor under the lease.

Brewer, 66 B.R. at 216. O'Connor involved a commercial lease, but the court held that the appropriate measure of damages was the total rent to be paid over the remainder of the lease term, less mitigation by releasing the premises, plus costs of construction to meet the needs of the new tenants. O'Connor, 145 B.R. at 893.

In this case Plaintiff is entitled to all unpaid rent and fees owing at the time the Debtors vacated the property as well as rent for the remainder of the lease term, less any rent Plaintiff received from a new tenant upon re-leasing the property, and less the security deposit he retained, for a total of \$6,362.50. In addition, Plaintiff is entitled to the costs of advertising to secure a new tenant in the amount of \$409.00, reimbursement for the maintenance and repairs which the Debtors were obligated to perform under the lease in the amount of \$735.00, and reimbursement for changing the locks and cleaning the property in the amount of \$580.00, as those costs were incurred as a result of the Debtors failing to return their keys and clean the home as they were required to do under the lease.

As for the damages incurred as a result of the lost furniture market rental, the court finds that Plaintiff is entitled to recover the \$4,000.00 as the loss was proximately caused by the Debtors' breach of their obligations under the lease. The lease agreement required Debtors to provide a furnished home for the furniture market renters, and Plaintiff lost the rental income as

a direct result of not being able to provide furnished accommodations. Plaintiff took steps to try to mitigate this damage by trying to convince the Debtors to stay in the premises and by trying to secure another tenant once it was clear the Debtors would not be remaining in the home.

This court finds that Plaintiff is entitled to interest at the current federal rate from the date the adversary proceeding was filed. Id. Thus, the total amount owed Plaintiff, including interest as of the date of the entry of the judgment entered contemporaneously herewith, is \$13,196.20, and such debt is nondischargeable under § 523(a)(2)(B).

CONCLUSION

In accordance with the foregoing, a judgment will be entered contemporaneously herewith adjudging that the Plaintiff is entitled to recover the sum of \$13,196.20 from the Debtors which is nondischargeable under § 523(a)(2)(B) of the Bankruptcy Code.

This 30th day of July, 2004.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION



IN RE:

Brian Douglas Fisher and
Melinda Bailey Fisher,

Debtors.

Case No. 00-10738C-7G

Frank A. Francin,

Plaintiff,

v.

Adversary No. 03-2024

Brian Douglas Fisher and
Melinda Bailey Fisher,

Defendants.

JUDGMENT

In accordance with the memorandum opinion filed contemporaneously herewith, it is ORDERED, ADJUDGED AND DECREED that the Plaintiff have and recover of the Debtors the sum of \$13,196.20 which is hereby adjudged to be nondischargeable pursuant to § 523(a)(2)(B) of the Bankruptcy Code.

This 30th day of July, 2004.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge