Central Bank & Trust Co. v. Macke Doc. 24

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

CENTRAL BANK & TRUST, : NO. 1:10-CV-00195
:
Plaintiff Appellant, :
: **OPINION AND ORDER**
v. :
:
:
MICHAEL ROBERT MACKE, :
:
Defendant Appellee. :

This matter is before the Court on Plaintiff Appellant's Appeal from Adversary Proceeding (doc. 21), Defendant Appellee's Brief (doc. 22), and Plaintiff's Reply Brief (doc. 23). For the reasons indicated herein, the Court affirms the Bankruptcy Court's decision that debtor's loans are dischargeable, rejects Appellant's arguments to the contrary, and denies the appeal (doc. 1).

I. Background

The facts of this case were detailed in the Bankruptcy Court's February 8, 2010 Order which is subject of Appellant Central Bank & Trust's ("Bank") instant appeal (doc. 7, ex. 25). The parties dispute the dischargeability of two loans made by Appellant Bank to Appellee Michael Robert Macke ("Macke") in the amounts of $500,000 and $100,000, which the Bank contends it approved as a result of Macke's misrepresentations (Id.). Under the Bankruptcy Code, debts which are obtained through "false pretenses, a false representation, or actual fraud," will not be

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discharged, so long as the creditor proves it justifiably relied on such misrepresentations. 11 U.S.C. § 523(a)(2)(A). Similarly, debts that are obtained through the use of a materially and intentionally false written statement regarding the debtor's financial condition, upon which a creditor reasonably relies, will not be discharged. 11 U.S.C. § 523(a)(2)(B). Both sorts of alleged misrepresentations are at issue in this case.

A. The Statement of Financial Condition

The parties devoted the major part of their original briefing to the Macke's July 11, 2006 Statement of Financial Condition ("Statement"), which he submitted to the Bank when seeking loans. The Bank contended that Macke misstated the values of various real estate properties which he had an interest in and included on the Statement, in violation of Section 523(a)(2)(B) (doc. 7, ex. 25).

The Bankruptcy Court stated the requirements a creditor must prove by a preponderance of the evidence to satisfy a Section 523(a)(2)(B) claim (Id.). The Bank must prove: 1) a materially false statement in writing, 2) upon which the creditor reasonably relied, 3) respecting the debtor's financial condition, and 4) that the debtor caused to be publised with intent to deceive (Id. citing Fahey Bank v. Benton (In re Benton), 367 B.R. 592, 596 (Bankr. S.D. Ohio 2006)).

To support its claims at trial, the Bank proffered

testimony from real estate appraiser, Gary S. Wright, and accounting agent, Calvin D. Cranfill. Wright testified that Macke had misstated the values of two real estate properties listed on the Statement (Id.). However, the Bankruptcy Court found that Wright had not appraised these properties fully, and therefore such testimony could not be relied upon to show misrepresentation of the values of these assets (Id.). Cranfill testified that Macke had double-listed the Orchard Hills Golf Center on the Statement, thus increasing the report of total assets (Id.). However, the Court rejected such testimony, finding no duplication in the Orchard Hills listings, which referred separately to a golf course and residential lots which had been carved out from the property (Id.).

The Bank also asserted that Sugar Ridge Golf course, which had been appraised at $4,000,000 in January, 2006 was improperly listed on the Statement as worth $4,500,000 (Id.). The Court found well-taken Macke's position that the $4,000,000 appraisal did not include two added holes and upgrades to the pump station, cart paths, and an irrigation system which he valued at $500,000 (Id.). As such the Court found the valuation of $4,500,000 correct (Id.).

Thus, the Bankrupty Court found that the Bank failed to carry its burden that Macke materially misrepresented the values of real property items on the Statement (Id.). There was no testimony presented to show that items aside from real estate influenced the

Bank in granting the loan, and therefore the Bankruptcy Court concluded the Bank failed to prove that any of the other items listed on the Statement[1] influenced the Bank in making the loan (Id.).

Finally, the Bankruptcy Court concluded, based on testimony of Matthew Eilers, the Bank's loan officer, that Eilers had paid little attention to the Statement at all (Id.). "Even if we were to assume that there were misrepresentations in the Statment," opined the court, "Plaintiff did not rely on them, certainly not reasonably, in making the loans to Defendant's entities" (Id.). The Court found that Eilers ignored the second page of the statement, which annotated Macke's actual ownership interests in each of the listed assets on the Statement (Id.). Instead, the Court found, Eilers relied on Macke's credit report, his business reputation, and reports from other banks that Macke had met his loan payments in the past (Id.).

B. Macke's Representations Regarding the Purpose of the Loans

The Bank further complains that Macke misrepresented the purpose of the loans he sought, in violation of 11 U.S.C. § 523(a)(2)(A) (doc. 7). The court stated that proof of actual fraud under Section 523(a)(2)(A) requires, 1) false representation, 2) knowledge that the representation was false, 3) intent to deceive,

[1]These items fell within five categories: cash, escrow, notes receivable, notes payable, and stocks.

4) justifiable reliance on the representation, and 5) proximate cause of damages (Id. citing Nunnery v. Rountree, 478 F.3d 215, 218 (4th Cir. 2007), Rembert v. AT&T Universal Card Servs. (In re Rembert), 141 F.3d 277, 281 (6th Cir. 1998)). The burden is on the Bank to prove each of these elements by a preponderance of the evidence (Id. citing Grogan v. Garner, 498 U.S. 279, 290-91 (1991)).

The Court reviewed the Bank's Section 523(a)(2)(A) claims and found any alleged misrepresentation immaterial, and further, found unreliable Eiler's testimony in support of such claims (Id.). As for the $500,000 loan, the Court found Eiler's testimony contradictory as to his view of Macke's intended use of the proceeds (Id.). Macke used the $500,000 loan to pay for construction projects relating to the Sugar Ridge Golf Course (Id.). At trial Eilers testified at different times that he understood when he approved the loan that some of the work was already completed, but also, in contradiction, that he would not have approved the loan had he known it was mostly for completed work (Id.). On this testimony the Bankruptcy Court found that Appellant had not met its burden to prove misrepresentation (Id.).

When seeking the $100,000 loan, it is uncontested that Macke showed the Bank seven checks as evidence of how Macke intended to pay certain parties from the loan proceeds (Id.). While it is further uncontested that Macke paid each of the parties

after he received the loan, the Bank claims that because Macke did not actually use three of the checks, he misrepresented the use of the loan proceeds (Id.). The Court found the fact that Macke did not use three of the proffered checks immaterial, citing In re: Sheridan, 57 F.3d 627 (7th Cir. 1995) in which the court found no fraud where debtor made deposits with money other than that advanced by creditor, holding that "money is interchangeable" (Id.). The Court further concluded the Bank could not have justifiably relied on the specific manner in which the creditors who were payees in the checks were paid, and that it was clear that Macke had no intent to deceive the Bank when he did not use three out of seven of the checks he showed when seeking the loan (Id.).

In light of the evidence, the Bankruptcy Court found the Bank had not met its burden of proof to render Macke's debt nondischargeable (Id.). The Bank proffered no evidence or argument in support of its third claim, regarding embezzlement, and the Court therefore found such claim abandoned (Id.).

II. Standard of Review

The Bank has filed its appeal pursuant to Title 28 U.S.C. § 158(a)(1)(2000), which states: "[t]he district courts of the United States shall have jurisdiction to hear appeals . . . from final judgments, orders, and decrees . . . of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title." 28 U.S.C. § 158(a). Under 28

U.S.C. § 158(c), appeals from core bankruptcy proceedings are required to be reviewed in the same manner as appeals in civil proceedings generally taken from District Courts; therefore Fed. R. Civ. P. 52(a) requires that findings of fact shall not be set aside unless clearly erroneous. Rule 52 is silent as to review of conclusions of law in bankruptcy cases and such issues must be reviewed de novo. In re Overly-Hautz Co., 81 BR 434 (N.D. Ohio 1987).

III. Discussion

The Bank argues in its appeal that the Bankruptcy Court made factual and legal errors in rendering its decision (doc. 21). The Bank contends Macke misrepresented his net worth and the values or ownership interests of real estate and other assets (Id.). The Bank further restates its claim that Macke misrepresented the purposes of the two loans, and alleges that misrepresentations on the Statement regarding Macke's personal assets should have been addressed by the Bankruptcy Court's decision (Id.). The Bank also contends the Bankruptcy Court erred as a matter of law in applying incorrect standards for materiality, reliance, and intent (Id.). In reviewing the Bankruptcy Court's factual determinations and the legal standards it applied, this reviewing Court finds no reversible error.

A. Factual Issues

The Bank contends the Bankruptcy Court failed to take

note of Macke's failure to list $2 million in liabilities and $12 million in personal guaranties on the Statement (doc. 21). In the Bank's view, Macke showed he had a $8 million positive net worth, when in reality, he was insolvent (Id.).[2]

The Court notes that the thrust of the Bank's arguments on appeal concern alleged misrepresentations in the Statement, upon which the Bankruptcy Court found the Bank did not even rely. The Bank further delved into arguments concerning property listed on the Statement that the Bankruptcy Court did not address, because the Bank offered no testimony that such items influenced its decision in making the loan. The Court finds no clear error in the Bankruptcy Court's factual determination that the Bank did not rely on the Statement, but rather relied on other factors in making its decision to grant Macke the loans. The evidence before the court showed that even if there were inaccuracies in the Statement, the Bank did not rely on it in any reasonable fashion, so it could not

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[2]The Bank further contends Macke listed in the Statement two "Notes Receivable" that did not exist: a $195,000 note from his daughter, Lauren Macke, and a $99,000 note for BDM Holdings (doc. 21). The Bank contends the Statement listed company-owned assets as personally-owned (Id.). It argues the Stock section of the Statement contained false statements regarding the worth of Macke's life insurance policy, country club membership, and stock value (Id.). It argues the Cash Section reported $167,335 in cash, but that Macke withdrew or spent some $120,000 or 71% of such amount (Id.). It argues the Real Property section of the Statement duplicated and overstated the value of real estate, and it argues Macke failed to perform work he said he would use the $500,000 loan for, including restaurant renovation, practice area construction, and restrooms (Id.).

claim it was deceived by the Statement. The Court finds no error in such conclusion.

Macke’s Brief (doc. 22), and a review of the Statement, shows Macke had ownership interests in more than $28 million in property. However, the Statement also clearly spells out that most of the properties were only partially owned. The Statement further shows nearly $19 million in loans as to such properties, and taken together with the financial statements of Macke’s companies, Macke clearly had more than $24 million in liabilities. That Macke clearly listed these values in the Statement belies the Bank’s claim that Macke misrepresented his financial condition when he submitted his Statement.

Macke’s response further takes issue with the Bank’s contention that he failed to report some $12 million in guaranty liabilities that showed up in Macke’s bankruptcy schedules. Macke contends the $12 million represents loans obtained after the initial loans of 2006, from the Appellant, and from other lenders. And finally, though the Court need not reach the minutiae of factual arguments regarding details of the Statement--upon which the Bank did not rely in granting the loans--it finds that Macke’s appeal brief adequately accounts for his accounts receivable and cash entries, and justifies that there was no double counting of properties in the Orchard Hills Investment or in the Sugar Ridge

Development.[3]

As noted by Macke, "there can be no doubt that [his] financial condition was somewhat involved" (doc. 22). He listed nine separate real estate holdings on his Statement, many of which were comprised of various parcels of differing values. Macke's testimony at trial, which the Bankruptcy Court found credible, showed that he offered to provide additional financial statements of his companies to the Bank, but Eilers declined. Instead, the facts show, Eilers relied on Macke's credit report, his reputation, and reports from other banks that Macke met loan obligations in the past. Under these circumstances, the Court finds no clear error in the determination that the Bank did not rely on Macke's Statement. The Bank cannot claim it was deceived by a Statement upon which it did not actually rely. Field v. Mans, 516 U.S. 59, 68 (1995).[4]

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[3]The Court further finds no error in the Bankruptcy Court's determination that the Bank's experts failed to make complete appraisals of the properties. Evidence at trial showed that Sugar View LLC was more than Lots 153, 154, and green space, but that there was a third unnumbered ten-acre parcel containing forty-eight building sites. Similarly, Wright appraised Lot 156, part of Sugar Ridge Land, without appraising Lot 157. Evidence at trial showed, contrary to the Bank's argument, that Lots 156 and 157 were not of equal value.

[4]The Bank further argues in its Reply (doc. 23) that it is inaccurate to state that the decision to grant the loan was Eiler's, as there was an underwriting process, that Eilers testified he was only "involved" in the loan analysis, and that he alone could not approve the loan. However, in addition to the fact that the Bankruptcy Court did not find Eilers a credible witness, there is no evidence in the record showing how the Bank's process in any way relied on Macke's Statement.

The Court further finds the Bankruptcy Court's conclusions correct regarding Macke's represention regarding the use of loans. The Bankruptcy Court did not err in making a credibility determination based on loan officer Eiler's conflicting testimony regarding the use of the $500,000.[5] Nor did it err in finding that Macke paid the bills he said he would pay after he received the $100,000 loan. The Bank's argument that it is the victim of fraud because Macke did not use three of the checks he had proffered falls flat. There is no dispute that Macke paid the bills, albeit without those three exact checks. The Bankruptcy Court did not err in finding such issue immaterial. In re: Sheridan, 57 F.3d 627 (7th Cir. 1995).

B. Legal Arguments

In Macke's view, the only issues on appeal are factual, and therefore the Court's only task is to determine whether the Bankruptcy Court clearly erred in its decision (doc. 22, citing Bankruptcy Rule 8013, In United States v. United States Gypsum Co., 333 U.S. 364 (1948)). Macke therefore does not address the Bank's efforts in framing its appeal as including legal issues. Out of an

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[5] The Bankruptcy Court's credibility determination regarding Eilers "must not be set aside unless clearly erroneous." Fed. R. Civ. P.(a)(6). Eilers testified that he would not have approved the loan knowing that much of the work was already completed. Yet the record shows he personally visted the golf course and saw that a substantial amount of the work was already completed and testified he understood as much when he approved the loan. The Court finds no clear error in the Bankruptcy Court's credibility assessment.

abundance of caution, the Court will address the Bank's legal arguments.

1. Materiality

The Bank first contends the court applied an incorrect materiality standard in its analysis of the non-real estate property items listed on the Statement (docs. 21, 23). In the Bank's view, under the correct standard the Bankruptcy Court should have determined whether there were substantial untruths that would normally affect the decision to grant credit (doc. 21, citing In re Norris, 70 F.3d 27, 30, fn.10 (5th Cir. 1995)(incorrectly cited as In re Woolum). According to the Bank, the court conflated its reliance analysis with its materiality analysis, and such error requires reversal, for failure to apply the correct legal standard to the facts.

The Bank fails to recognize, however, that each of the elements listed in Section 523(a)(2)(B) must be satisfied for the Court to make a finding of nondischargeability of debt. In re Benton, 367 B.R. 592, 596 (2006). To the extent the court conflated its analysis, any error is harmless, because there is no legal error when a court, finding a matter insufficiently proven as to one part of a multi-part test, declines to conduct a full analysis including all elements of the test. Here, the court found no question that the Bank failed to prove it reasonably relied on the Statement, as the Bank was required to do to satisfy 11 U.S.C.

§523(a)(2)(B)(iii).

2. Reliance

The Bank next argues the court applied an overly rigorous "reasonable reliance" standard (doc. 21). In the Bank's view, the Sixth Circuit standard of reasonable reliance is directed at creditors who act in bad faith in never looking at applicant financial statements or who even solicit false financial statements (Id. citing In re Woolum, 979 F.2d71, 76 (6th Cir. 1992), Bancboston Mortgage Corp. v. Ledford (In re Ledford), 127 B.R. 175, 178 (Bankr. M.D. Tenn. 1991)). In its view, the court failed to use a bad faith standard, but instead applied an overly rigorous reliance analysis. The Bank takes an overly simplistic view of the reliance analysis.

First, the Supreme Court has made it clear that Section 523(a)(2)(B) expressly requires not only reasonable reliance, but also reliance itself. Field v. Mans, 516 U.S. 59, 68. In this case, the facts show Eilers did not rely on the Statement, but rather on other factors in making his decision.

Second, In re Woolum shows that a bad faith analysis is triggered after it has been established that debtor has furnished a lender a materially false financial statement. 979 F.2d at 76. In this case, the Bankruptcy Court made no finding that Macke furnished a materially false Statement. In fact, the Bankruptcy Court found the Statement entries supported by facts in the record.

Finally, In re Ledford provides a survey of case holdings on the question of reasonable reliance. 127 B.R. 175, 177-81. Several principals are clear. In enacting the Bankruptcy Act, Congress was concerned that creditors use other data sources beyond a mere debt list, but also credit reports, all facts and circumstances, and the size of the loan. Id. at 178. A prior relationship of successful dealing between the borrower and the lender is a significant factor in making reliance reasonable. Id. at 179. Reliance is reasonable provided the representation relied upon appears sufficient and accurate. Id. The analysis of whether a representation is sufficient and accurate depends on whether there were "red flags," or facts that should have put the lender on notice. Id.

In this case the Bankruptcy Court found that Eilers did not take notice of the "red flags" on the Statement, the annotations on the second page which showed that Macke did not completely own all of the properties he listed on the first page. The facts further show that Macke and the Bank had no prior relationship. Regardless of the fact that the Bank did refer to data sources beyond the "debt list," the facts simply show it barely gave a cursory review to the debt list, as Eilers' testimony showed he did not understand Macke's ownership interests, as listed on the Statement. Under these circumstances it is clear the Bankruptcy Court applied the correct legal analysis in concluding

that the Bank did not reasonably rely on the Statement, and it was not required to conduct a "bad faith" inquiry.

In the balance of its arguments regarding reliance, the Bank argues the court erred by citing examples of reasonable reliance as reasons the Bank did not rely, it erred in ruling the bank did not actually rely on the Statement because it did not challenge its individual entries, and it erred in ruling the Bank did not actually rely on the Statement because it considered other factors (doc. 21). In support of its arguments, the Bank cites authority that shows bank can reasonably rely on net worth figures from sophisticated borrowers, that is, they can take such figures at their face. (Id. citing In re Viaro, 40 B.R. 776, 781 (Bankr. S.D.N.Y. 1984). However, the facts show that Eilers did not take the Statement at face value, because he failed to understand its annotations, which were in no way hidden. A creditor cannot raise the defense that it was dealing with a sophisticated businessman when it fails to read the document clearly stating the businessman's financial condition. The Bank's arguments repeatedly miss the mark: the Bankruptcy Court made no legal error in concluding the Bank did not reasonably rely on the Statement.

3. Intent

The Bank claims the court failed to apply to correct intent standard as to Macke's representation that he would use the proceeds of the $100,000 loan to negotiate seven specific checks.

The Bank argues that the Bankruptcy Court's reliance on In re Sheridan for the proposition that "money is interchangeable" is in error because in that case the debtor used his own funds to settle the obligations for which the loan had been secured. In this case, the Bank argues, Macke arranged for other sources, including his brothers, to pay the vendors, and Macke did not personally satisfy the obligations to the three vendors. The Bank relies on In re Eversole, 110 B.R. 318 (Bankr. S.D. Ohio 1990), which it argues shows the fact that although an obligation is satisfied from another source, debt can still be nondischargeable based on the debtor's misrepresentation. However, In re Eversole is not on point with the facts of this case, because in contrast, the court found evidence in the record showing the creditor made material and false representations to the creditor regarding the loan money he sought. 110 B.R. 318, 323. Moreover, it is misleading to state that the obligation in In re Eversole was satisfied by "another source." The debtor in In re Eversole used $100,000 the creditor lent him for personal debts, instead of for architectural and engineering fees as he had represented to the creditor. 110 B.R. at 323. The fees were already covered by a multi-million dollar construction ceiling to be paid by the creditor. Id. In re Eversole does not provide an example where a debtor used other sources at his disposal to accomplish what debtor represented he would do. It rather shows an example of debtor misusing funds for

personal debts and in no way accomplishing his obligation. Here, the Bank complains that Macke did not use three checks, but there is no dispute that he paid the creditors and accomplished his obligation.

The Bank argues the court failed to consider the circumstances surrounding Macke's request for the $100,000 loan, which it contends show Macke never intended to use the funds as represented. The court, however, did consider the circumstances, and properly inferred lack of fraudulent intent.

IV. Conclusion

Having reviewed this matter, the Court finds the Bankruptcy Court made no factual or legal error in its decision that would justify the nondischargeability of debtor's loans. Accordingly, the Court AFFIRMS the February 8, 2010 decision of the Bankruptcy Court dismissing Central Bank & Trust Company's Complaint seeking the nondischargeability of the $500,000 and $100,000 loans it issued to debtor Michael Robert Macke, and DENIES the Bank's appeal (doc. 1).

Dated: December 21, 2010

/s/ S. Arthur Spiegel
S. Arthur Spiegel
United States Senior District Judge