UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND
AT ROCKVILLE

IN RE:	:	
BRUCE D. GORDON LINDA A. GORDON	:	Case No. 90-4-3531-PM Chapter 7
Debtors	:	
POTOMAC COMMUNITY FEDERAL CREDIT UNION	:	
Plaintiff	:	
vs.	:	Adversary No. 91-A-0070-PM
BRUCE D. GORDON LINDA A. GORDON	:	
Defendants	:	

MEMORANDUM OF DECISION

Following trial, there is before the court for resolution the complaint filed on behalf of the Potomac Community Federal Credit Union ("PCFCU") seeking a determination that an obligation owed to it by the debtors, Bruce D. Gordon and Linda A. Gordon, is not dischargeable. The complaint is based upon 11 U.S.C. § 523(a)(2)(B) as to both defendants and 11 U.S.C. § 523(a)(4) as to the defendant, Bruce D. Gordon. This is a core matter that this court may hear and determine and enter a final order. 28 U.S.C. § 157(b)(2)(I)

The applicable Bankruptcy Code provisions, 11 U.S.C. § 523(a)(2)(B) and 523(a)(4), provide:

B-4

§ 523. Exceptions to discharge.

(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 the intent to deceive;

* * * *

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

The court announced its ruling as to the defendant, Linda A. Gordon, at the conclusion of the trial. The plaintiff had not sustained its burden of proof as to her, and the complaint would be dismissed as to her. Thereafter the court directed the parties to file memoranda in support of their positions and set this matter for final argument on March 25, 1992.

The court will deal first with § 523(a)(4), that excepts from discharge a debt for fraud or defalcation while acting in a fiduciary capacity.

In Davis v. Aetna Acceptance Co., 293 U.S. 328, 333, 55 S.Ct. 151, 153, 79 L.Ed. 393 (1934), the Supreme Court construed the "fiduciary capacity" language of section 17(a)(4) of the Bankruptcy Act of 1898, the predecessor to 11 U.S.C. § 523(a)(4). The Court required the existence of a technical trust relationship

prior to the transaction creating the debt, rather than one implied from contract. See also In re Dobbs, 115 B.R. 258, 263 (BC Idaho 1990); In re Marino, 115 B.R. 863, 868 (BC Md. 1990).

Thus, implied or constructive trusts and trusts ex maleficio, i.e., trusts imposed because of wrongdoing on the part of the person to be charged as trustee, do not support the establishment of a fiduciary relationship under § 523(a)(4). In re Brown, 131 B.R. 400, Me. 1991; In Re Beauchaine, 113 B.R. 116, R.I. 1990; In re Cairone, 12 B.R. 60, 62 (BC R.I. 1981), citing In re Thornton, 544 F.2d 1005 (CA9 1976); Central Hanover Bank & Trust Co. v. Herbst, 93 F.2d 510 (CA2 1937).

Similarly, ordinary commercial relationships such as creditor-debtor do not create the requisite fiduciary relationship to support a denial of discharge. Cairone, supra, 12 B.R. at 62, citing Angelle v. Reed, 610 F.2d 1335 (CA5 1980); Devaney v. Dloogoff, 600 F.2d 166 (CA8 1979).

In an analogous case, Harasymiw v. Selfreliance Federal Credit Union, 97 B.R. 924 (N.D. Ill. 1989), the court held that the debtor's status as director and attorney of a credit union did not create a fiduciary relationship for the purpose of finding the debt owed by the debtor to the credit union was nondischargeable on the basis of section 523(a)(4). Specifically the court determined that § 523(a)(4) was applicable only to those cases where monies came into the debtor's hands that were entrusted to the debtor as a fiduciary.

Moreover, in In re Gans, 75 B.R. 474 (S.D.N.Y. 1987), the

court noted the distinction between the relationship of a trustee and beneficiary and the relationship of a debtor and creditor. The court recognized:

> [a] trust involves a duty of the fiduciary to deal with particular property for the benefit of another. The beneficiary of the trust has an equitable interest in the trust property and is, in fact, its equitable owner. The debtor-creditor, on the other hand, involves only the obligation to pay money; it endows the creditor with merely a personal claim against the debtor.

Id. at 490.

Here the alleged fraud came about as a result of the debtor's application for a loan from the credit union, on whose board he served. He was not acting as trustee in the action challenged and made no fiduciary determination. The court concludes that the plaintiff has not sustained its burden of proof as to Count II as to the defendant Bruce D. Gordon (hereinafter "debtor").

The debtor had been a member of the board of directors at PCFCU for 5 or 6 years. His term of office ended in the spring of 1991. There was testimony that he was removed from performing duties at the suggestion of the National Credit Union Administration. While as a director he served on a loan committee. That committee had the charge to review loans above the authorization of the loan officer, to review denials and to review generally the portfolio of loans made.

In the spring of 1989, the debtor called the president of the credit union, Bruce Patner at his law office, and explained that he wished to extend his line of credit. The loan was to be

replaced by a second loan made by both the debtor and his spouse and to be secured by certain equipment belonging to his wholly owned corporation, Plain 'N Fancy Donuts, Inc. He requested $100,000.00 for a loan to the business. Debtor was told to submit an application to the loan officer. Upon receipt of the application, the president appointed a committee of the Board of Directors to investigate the loan--Theodore Goldberg, Elliot Dannenberg, and Leslie Mays. The committee was asked to evaluate the loan and make a recommendation, because the requested loan was to a director who was a member of the loan committee as well as for the reason that the loan request was in a large amount.

Additional material was submitted, that is, a financial analysis of the business. It was prepared by the debtor's accountant, Joseph Luber, also a member of the Board of Directors of the credit union. Received in evidence were the loan application and the financial statement. Joseph Luber was called by the plaintiff and testified that he and the debtor and their wives had been close friends for twenty-five years, that he had loaned the debtor substantial sums of money and was scheduled as an unsecured creditor with a claim of $50,000.00. At the time of the making of the loan application on July 21, debtor owed Luber $14,071.00. This debt was not expressly disclosed by either to the Board of Directors. Mr. Luber abstained from voting on this matter. When asked why he did not say anything about the loan, he said that he just did not think about it. At the request of Bruce Gordon, Mr. Luber took some information from defendant's books and

records, assembled it by a computer, met with the audit manager of his accounting firm and prepared a compilation review. A compilation is a statement prepared by an accountant, based on data submitted by the client. The accountant does not verify the accuracy of the underlying material in a compilation. Morin v. Trupin, 778 F.Supp. 711 (S.D.N.Y. 1991); Thomas v. U.S., 758 F.Supp. 529, 534-535 (E.D. Mo. 1991).

Linda Gordon testified that Bruce Gordon had bought out his brother's interest. She recalled that on June 9, 1989, her husband asked her to go to her cousin, Shelton Zuckerman, for a loan. On cross-examination it was elicited that the couple was then under tremendous financial problems and that debtor needed $80,000.00 for his business.

Two members of the loan committee said that they relied upon the financial statement, that they were very much impressed by the net worth shown of $1.5 million. Both testified that had they known that the debtor owed money to Joe Luber, that such a direct conflict of interest would have affected their decision. They relied on the financial statement because they had every reason to believe their fellow director, and gave him the benefit of the doubt. Had they known of the existence of the loan from Luber, they would have either required an audited financial statement or they would have fly-specked everything in the financial statement. The witness, Theodore Goldberg, testified that the debtor said that he would not give the credit union a lien on the home, that the debtor had said that he promised his

brother that he would not put any further encumbrances on the house. The witness understood from this that the debtor was looking out for his family to protect it from any untoward situation. He further testified that if he had known about the existence of the additional deed of trust securing debtor's brother, that fact would have degraded his entire feeling about the proposed loan and he would have had considerable difficulty in reaching a conclusion that the debtor had the ability to service the loan.

Debtor testified that the obligation to his brother came about a week after the application was made. While the deed of trust was dated July 14, 1989, it was not signed until July 28, 1989, after the application was presented. However, the court finds that the debtor purposefully omitted the obligation to his brother from the schedule.

On September 7, 1989, the day of the settlement of the loan from the credit union, the debtor added his wife, Linda Gordon, as a co-applicant to the loan application, by himself under a power of attorney. The financial statement was accepted by plaintiff without much inquiry into the significance of the underlying data concerning debtor's business. The financial statement contained the statement "I hereby certify that the above is a true and correct statement as to the date above stated and I understand that any credit now or hereafter given me is made upon the correctness of the statements contained herein." The very first paragraph of the statement points out "the undersigned warrants

that this financial statement is true and correct as to the 21st of July, 1989, and that it may be relied upon as continuing to be true and correct unless a written notice of change is provided by the undersigned." Contrary to that expressed statement, the debtor neglected to disclose the note and deed of trust upon his residence that was held by his brother and sister-in-law. The debtor knew that the nondisclosure was false. Indeed, as pointed out by Theodore Goldberg, the debtor quibbled about putting another lien on the property "because he had promised his brother not to do so." The court infers from this at the debtor did not want a title search made of the subject property in anticipation of a loan secured by the family home, because that would disclose the existence of the obligation to his brother and sister-in law. Finally, were the court to find that the prior statement and omissions of debtor were not fraudulent, debtor republished the false statement on September 7, 1989, when he signed it as his wife's attorney in fact. Similarly, the statement omitted the Zuckerman trust recorded August 10, 1989.

This is a very close case in one aspect of the requirements of § 523(a)(2)(B). Obviously the representation given was false in its omission of the two liens and the obligations they secured. The publication of the falsehood was repeated at the time of the republication of the document. The statement related to the financial condition of the debtor. The creditor reasonably relied upon the statement, and the debtor caused it to be published with the intent to deceive. The tougher issue is whether the statement

was material or not, or whether the loan committee would have made the loan in any event. While there is considerable testimony that the loan committee was swayed by the numbers on the "left-hand" side of the financial statement, there was testimony also that knowledge of the existence of two encumbrances would have caused a revisit and reanalysis of the obligation and that in all likelihood the loan would not have been made.

The issue of the failure to disclose the obligation to Joseph Luber is as much the fault of Mr. Luber as it is of the debtor. Mr. Luber was likewise a member of the Board of Directors. Debtor showed some $55,000.00 payable to relatives and friends and an additional $60,000.00 in miscellaneous accounts payable. The statement does not request the names of the creditors. The court therefore finds that the omission of the identification of Joseph Luber was not a material misrepresentation.

The court is cognizant of the fact that creditors have no obligation to verify all of a debtor's statements in order for the court to find that they have reasonably relied on the debtor's false representations. In re Howard, 73 B.R. 694 (BC N.D. Ind. 1987). This is particularly so where, as here, the parties were not strangers but were co-fiduciaries of the institution making the loan.

The facts that tip the scale in this situation of near equipoise are (1) the debtor's equivocation about his brother not wanting any more encumbrances, and (2) the debtor's position as a

director and a member of the loan committee of the Potomac Community Federal Credit Union. In such capacity, he knew the importance of the financial statement. He knew based upon his personal standing and his unblemished reputation at that time, that the statement would be received at face value. He knew further that it would be relied upon by his fellow directors. The court, therefore, will enter judgment in favor of the plaintiff against the defendant.

At the time the loan was made, the testimony is that the debtor was in a precarious financial statement. The testimony also is that he received $40,000.00 on account of the extension of credit. The court will, therefore, limit the amount of the judgment to that $40,000.00 with interest from February 28, 1991, the date of the filing of this adversary proceeding. Counsel for the plaintiff shall present an order in accordance with the foregoing.

Paul Mannes

PAUL MANNES, Chief Judge
United States Bankruptcy Court
for the District of Maryland

DATE: April 6, 1992

ENTERED: 4-8-92

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