Crocker v. Matthews

In re Matthews, 599 B.R. 838 (Bankr. D. Md. 2019)

U.S. Bankruptcy Court for the District of Maryland
Adversary No. 17-00447-DER, ECF No. 48
Memorandum Opinion entered April 30, 2019

Original PDF pages 1–2, 28–31, and 37–38 follow.
These pages show the court’s opening summary, the statutory framework and the conclusion. The source pages retain their original numbering; intervening pages and exhibits are not included. This is not the full opinion or a separate judgment.

Entered: April 30th, 2019
Signed: April 30th, 2019

DAVID E. RICE
U. S. BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND
(Baltimore Division)

In re:	*	
JOSHUA MATTHEWS,	*	Case No. 17-17605-DER
Debtor.	*	(Chapter 7)
* * * * * * * * * * * * *		
SCOTT CROCKER, et ux.,	*	
Plaintiffs,	*	
vs.	*	Adversary Pro. No. 17-00447-DER
JOSHUA MATTHEWS,	*	
Defendant.	*	
* * * * * * * * * * * * *		

MEMORANDUM OPINION

Joshua Matthews ("Matthews") was the founder of Bulk Head Brewing Company, LLC ("BHB"), a failed start-up craft brewing business. Scott and Leah Crocker invested $52,000 in equity interests in BHB in August and September of 2016. Scott Crocker ("Crocker") later guaranteed a $100,000 loan by Howard Bank to BHB in January of 2017. Ultimately, BHB

never opened for business and Crocker paid $98,560.13 in November of 2017 to satisfy BHB's loan liability to Howard Bank. The Crockers thus lost $150,560.13 on their investments in BHB.

In June of 2017, Matthews filed a voluntary Chapter 7 bankruptcy petition in this court. Thereafter, the Crockers filed this adversary proceeding, in which they seek a determination that their claims against Matthews are excepted from discharge (that is, nondischargeable) under 11 U.S.C. § 523(a)(2). A trial on the merits was conducted on December 4, 6, and 7, 2018. At trial, Matthews, Crocker, and several other witnesses testified, and the parties offered numerous exhibits that were introduced into evidence. Leah Crocker did not testify at trial in support of her claims. The Crockers asserted at trial and in closing argument that their claims are nondischargeable because Matthews made false statements about (i) BHB's liability to its landlord, (ii) BHB's liability to its general contractor for the buildout of the premises it intended to use for operation of a microbrewery, and (iii) BHB's licenses.

Following trial, the court held this matter under advisement. For the reasons explained below, the court has determined that 11 U.S.C. § 523(a)(2) does not apply and that thus the claims of the Crockers are subject to discharge.[1]

JURISDICTION

The court has subject matter jurisdiction over this proceeding under 28 U.S.C. § 1334, 28 U.S.C. § 157(a), and Rule 402 of the Local Rules of the United States District Court for the District of Maryland. This is a "core proceeding" under 28 U.S.C. § 157(b)(2)(I). This memorandum opinion constitutes the court's findings of fact and conclusions of law in

[1] In his main bankruptcy case, Matthews was granted a Chapter 7 discharge on November 15, 2017. See *In re Joshua Matthews*, Case No. 17-17605-DER [Docket No. 21]. No creditors other than the Crockers filed a complaint for determination of nondischargeability pursuant to 11 U.S.C. § 523(b). On August 2, 2017, the Chapter 7 trustee filed a Report of No Distribution, in which the trustee requests that he be discharged from office because he made diligent inquiry and determined that there is no nonexempt property to be administered for the benefit of creditors [Main Case Docket No. 20]. In other words, this is a routine no asset Chapter 7 case but for the claims made by the Crockers.

Congress set forth the exception to discharge at issue here as follows:

> A discharge under section 727 … of this title does not discharge an individual debtor from any debt for money … to the extent obtained by (A) false pretenses, a false representation, or actual fraud, *other than a statement respecting the debtor's or an insider's financial condition*; (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 … reasonably relied; and (iv) that the debtor caused to be made or published with intent to deceive; or (C) ….

11 U.S.C. § 523(a)(2) (emphasis added).

As the Fourth Circuit has explained, a creditor asserting a claim for nondischargeability under § 523(a)(2)(A) must prove five elements by a preponderance of the evidence—namely, "(1) false representation, (2) knowledge that the representation was false, (3) intent to deceive, (4) justifiable reliance on the representation, and (5) proximate cause of damages." *Nunnery v. Rountree (In re Rountree)*, 478 F.3d 215, 218 (4th Cir. 2007). As indicated by the Fourth Circuit in *Nunnery v. Rountree*, "Congress intended § 523(a)(2) to protect creditors who were tricked by debtors into loaning them money or giving them property, services, or credit through fraudulent means." 478 F.3d at 219-20. Section 523(a)(2)(A) was written by Congress in the conjunctive. Thus, a plaintiff must prove each element in order to prevail and failure to prove any one of them means a court must find that the debt in question is subject to discharge.

The dischargeability of claims based upon a debtor's statements regarding financial condition, however, are governed not by § 523(a)(2)(A), but by § 523(a)(2)(B) of the Bankruptcy Code. As this court has previously explained,

> In order to sustain an action under Section 523(a)(2)(B) of the Bankruptcy Code, a plaintiff must show that: (1) the defendant made a written statement; (2) the written statement was about her financial condition; (3) the statement was materially false; (4) the defendant published the statement with the intent to deceive the

> plaintiff; and (5) the plaintiff reasonably relied on the false statement. The intent to deceive may be inferred by the totality of the circumstances, including a debtor's knowing or reckless disregard for the accuracy of financial statements. A written statement is materially false if it paints a substantially untruthful picture of the defendant's financial condition by misrepresenting information of the type that would normally affect a plaintiff's decision to grant credit. Mere inaccuracy is not sufficient, rather, material falsity requires a significant understatement of liabilities or exaggeration of assets.

Guaranty Residential Lending, Inc. v. Koep (In re Koep), 334 B.R. 364, 372-73 (Bankr. D. Md. 2005) (citations omitted). Like § 523(a)(2)(A), § 523(a)(2)(B) is written in the conjunctive. Thus, a court must find that a debt is subject to discharge unless a plaintiff proves each element specified in § 523(a)(2)(B).

If a statement concerns the financial condition of the debtor or (as here) an insider of the debtor, the § 523(a)(2) exception applies only if the statement was made in a writing used by the debtor. The Fourth Circuit has long held that such a statement need not be a formal financial statement to fall within the scope of § 523(a)(2)(B). *Engler v. Van Steinberg (In re Van Steinburg)*, 744 F.2d 1060 (4th Cir. 1984). As this court has also previously pointed out, "with respect to the first element, the statement must have been either written by the debtor, signed by the debtor, or written by someone else and then adopted and used by the debtor." *Jones v. Owens (In re Owens)*, 549 B.R. 337, 349 (Bankr. D. Md. 2016). *See also, Hudson Valley Water Res. Inc. v. Boice (In re Boice)*, 149 B.R. 40, 45 (Bankr. S.D.N.Y. 1992) ("It is sufficient that Debtors either wrote, signed, or adopted such statement to find that documents were 'written' by them.").

The Fourth Circuit has also long held that for purposes of § 523(a)(2)(B) a statement "respecting" a debtor's financial condition is any statement that has bearing on the debtor's financial status, not just a statement regarding the debtor's overall financial status. *Engler*, 744

F.2d at 1062 ("A debtor's assertion that he owns certain property free and clear of other liens is a statement respecting his financial condition. … Consequently, the statement must be in writing to bar the debtor's discharge.") (citing *Blackwell v. Dabney (In re Blackwell)*, 702 F.2d 490 (4th Cir. 1983)). In *Blackwell*, the Fourth Circuit held that oral representations made by an individual debtor about the financial condition of a corporation that was an insider were "outside the scope of 11 U.S.C. § 523(a)(2) and cannot be the basis for preventing discharge of the bankrupt." 702 F.2d at 492.

The Supreme Court's recent decision in *Lamar, Archer & Cofrin v. Appling*, 138 S.Ct. 1752 (2018), concerning the scope of § 523(a)(2)(B) is particularly significant here. In that case, the Court determined that the bankruptcy court should have dismissed a complaint under § 523(a)(2) for failure to state a claim because the alleged false statement was an oral one concerning a ***single asset*** of the debtor. The Court specifically rejected the interpretation that a statement "respecting" a debtor's financial condition only referred to statements encompassing the debtor's overall financial status. The statement must simply have "a *direct relation to or impact on the debtor's overall financial status*." *Id*. at 1761 (emphasis added). Given this, the Court found "[a] single asset has a direct relation to and impact on aggregate financial condition, so a statement about a single asset bears on a debtor's overall financial condition and can help indicate whether a debtor is solvent or insolvent, able to repay a given debt or not." *Id*. It follows from this reasoning that a statement about a single liability—namely, the amount owed by BHB to the landlord or Domco—is also a statement respecting financial condition that § 523(a)(2)(B) requires be made in writing for the exception to discharge to apply.

With these general principles in mind, the court turns to consideration of the merits of the claims made against Matthews. The plaintiffs assert two distinct claims for

nondischargeability—first, that the $52,000 lost on their two equity investments in BHB is not dischargeable under § 523(a)(2) of the Bankruptcy Code by reason of false statements by Matthews about (i) BHB's liabilities to its landlord and Domco, and (ii) BHB's licenses; and second, that the $98,560.13 paid by Crocker to Howard Bank is not dischargeable under § 523(a)(2) by reason of false representations made by Matthews to the bank in the loan documents, which Crocker asserts he is entitled to enforce by means of subrogation. As the court will explain in turn, none of these claims has merit.

The First Equity Investment

Leah Crocker's claim with respect to the initial $36,000 equity investment in BHB must be denied because no evidence was presented with respect to the key element of a claim under § 523(a)(2)—namely, a representation made by Matthews on which she relied in fact. Her interaction with Matthews concerning both equity investments was limited to the meeting at the BHB business premises on August 10, 2016. Leah Crocker did not testify at trial. Her testimony would, of course, be the strongest evidence that Matthews made a representation on which she relied. While it might be possible to establish that fact through the testimony of other witnesses present at the meeting, the evidence presented here does not support such a conclusion.

Crocker's testimony about the August 10, 2016 meeting did not indicate anything about the substance of any statement made to Leah Crocker by Matthews during that meeting. In his testimony, Matthews described his meeting with Leah Crocker only in general terms. Nothing in the evidence presented indicates that Matthews and Leah ever discussed the subject of BHB's licenses or its liabilities to the landlord and Domco. That being the case, her claim for

The Howard Bank Loan Guarantee

Crocker's claim against Matthews with respect to the Howard Bank loan is founded on his assertion of a right of subrogation to the rights of the bank against Matthews, including its right (if any) to assert that its claim against Matthews is nondischargeable under § 523(a)(2) of the Bankruptcy Code. In this regard, Crocker relies on § 509 of the Bankruptcy Code as well as published opinions in *In re Morrison*, 555 B.R. 92 (Bankr. D. Mass. 2016), *Anderson v. SunTrust Mortgage, Inc. (In re Judd)*, 471 B.R. 830 (D.S.C. 2012), and *Cornmesser v. Swope (In re Cornmesser's, Inc.)*, 264 B.R. 159 (Bankr. W.D. Pa. 2001). None of these authorities, however, directly address the question presented here—namely whether a guarantor is subrogated to a creditor's right to assert issues of nondischargeability against not just the primary obligor, but also against a co-guarantor. For purposes of this memorandum opinion, the court assumes without deciding that Crocker is entitled by right of subrogation to assert any claim Howard Bank might have had for nondischargeability of its debt against Matthews, at least (as discussed in *Morrison*) to the extent of the amount of the claim Crocker holds against him under the principles of contribution.

However, even if Crocker is entitled to the right of subrogation with respect to any claim of nondischargeability against Matthews with respect to the Howard Bank loan, there was simply no misrepresentation by Matthews that warrants holding that Howard Bank's claim is nondischargeable. Crocker's sole argument was that boilerplate language in the Business Loan Agreement that BHB had all necessary licenses to do business was a misrepresentation because BHB did not have a state or county liquor license. At the time of the loan, however, BHB's business was not as an operating microbrewery; its business was to complete the buildouts necessary to open (and thus get the licenses that required a final inspection of the completed

premises). No evidence was introduced at trial of any actual reliance by Howard Bank on this boilerplate language. In any event, Howard Bank was fully aware at the time the loan was made that BHB was not yet an operating business. Accordingly, the court concludes that no misrepresentation was made to Howard Bank in the Business Loan Agreement. Because the court finds that Howard Bank has no claim for nondischargeability on the grounds of misrepresentation, Crocker's assertion of this right by subrogation must be denied as well.

CONCLUSION

In sum, the court finds the claims of the Crockers simply to be the result of a bad investment. It is understandable that they are unhappy that their investment did not turn out the way they hoped. Their disappointment, however, does not equate to fraud on the part of Matthews. Bankruptcy is meant to protect debtors like Matthews from a life of financial ruin due to bad business judgment. For the reasons stated above, the court will enter a separate order consistent with this memorandum opinion that denies the Crockers' request that their claims be held to be nondischargeable.

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-- END OF MEMORANDUM OPINION --